

BiH Economic Update

**1999 – Fourth Quarter
February 25, 2000**

**This report can be found on USAID website address :
www.usaid.ba/information/sheets.htm**

BiH Economic Update - Table of contents

I.	Recent Economic Trends	4
II.	National Income and Economic Activity	8
	A. National Income	8
	B. Economic Activity	10
III.	Foreign Trade	17
IV.	Population and Labor Market	21
V.	Prices and Wages	26
	Wages and Purchasing Power	26
	Exchange Rates	27
VI.	Fiscal Indicators	28
VII.	Monetary and Financial Sectors	32
	A. Banking	32
	B. Payments System	35
VII.	Privatization	38
	A. Federation of Bosnia and Herzegovina	38
	B. Republika Srpska	39
	C. Trading of Claims	40
Annex-1 :	Regional statistics	41
Annex-2 :	Profile of the industrial sector in the Republic Srpska	44

Preface

This Quarterly Economic Update summarizes key economic indicators for the Bosnia and Herzegovina, and analyzes their trends. The sources of statistical information are the Federation and the Republika Srpska (RS) Statistical Institutes, the EC-funded Customs and Fiscal Assistance Office (CAFAO), the Central Bank of Bosnia Herzegovina (CBBH), Federal Institute for Development Programming, RS Customs Department, IMF (Direction of Trade Statistics), World Bank, and incidental data sources.

Data should be used with caution and interpreted carefully. Important statistical series are missing due to the lack of resources necessary for data collection and surveys. The existing series suffer from serious coverage, methodological and reporting gaps. Furthermore, statistical reports are not user-friendly.

The gross domestic product (GDP) figures are only estimates, as they cannot be calculated with any degree of accuracy since neither production, income, or expenditure are fully covered. In general, the real-sector data underreport the size of the economy, due to the lack of data on the “shadow economy”. At the same time, capital and labor incomes are underreported even in registered businesses; and household consumption is difficult to estimate, as no household budget surveys have been carried out, and, foreign trade is underreported.

I. Recent Trends

After four years of double-digit (real) growth in gross domestic product (GDP), driven mainly by donor-fueled physical reconstruction and economic reactivation operations, growth has returned to single-digit figures. Whereas early 1999, economic analysts expected (real) growth to range from 13 to 20%, the World Bank had later brought down its forecast for 1999 to 8%.¹ We expect that real GDP growth in BiH will be between 5% and 8%. The Kosovo conflict will have had repercussions on the BiH economy, in particular in the RS. More significant, the absence of real restructuring in the State-Owned Enterprises delays sustainable growth. Finally, as donor-fueled capital flows are to remain large but without growth, the Priority Reconstruction Program will not generate extra growth.

Federation. Industrial production advanced 10.6% in the period January to December compared to the same period in 1998. However construction activity and transport (of goods) declined. Production of the electrical power industry increased only marginally, as did registered employment and tax revenue (+4.5%). Forestry production is up 13% in 1999 compared to 1998.

The industrial sub-sectors registering the weakest performance were: coal mining (-3.8%), textiles (-14.1%) and wearing apparel (-13.6%), fabricated metal products (-8.8%), machinery (-2.6%), electrical machinery (-14.2%), transport equipment (-5.5%). It is disturbing that growth was negative or flat in many sectors where the Federation ought to enjoy a comparative advantage.

The industrial sub-sectors registering the strongest performance were: tobacco products (+85.5%), manufacture of pulp, paper and paper products (+26.3%), chemicals and chemical products (+16.3%), rubber and plastics products (+35.9%), basic metals (+61.1%).

Between December 1998 and December 1999 registered employment increased by only 3,057 units. The average employment level in 1999 was just 3.1% higher than in 1998.

Net wages increased 13.8% in 1999 compared to the average level of 1998, while retail prices fell marginally (-0.9%). However, net wages growth is decelerating rapidly; in the last twelve months until December, net wages increased 8.1%.

The Federal Institute of Statistics reports **Inter-Entity trade**.² In the fourth quarter of 1999, KM 44.35 million worth of goods had been traded between the Entities. Though Inter-Entity trade is

¹ However, the bank still expects 14 % growth in 2000 and 2001. See "Bosnia and Herzegovina : Enterprise and Bank Privatization Adjustment Credit", IDA/World Bank, June 1999.

² According to Decrees issued by the Federation (August 1998) and the RS (October and November 1998), inter-Entity traded has to be registered. The Federation Decree stipulates that the trader must file a report to the Canton authority competent for trade. The report will contain the following information: identification of the trader in the Federation, identification of the trader in the RS, commodity data (description and quantity of commodities, KM value, method of payment, origin of commodity, date of delivery), other data (number and date of delivery form,

rising and though official data are believed to underreport the real level of trade between the Entities, it still is dwarfed by foreign trade.

Table 1: Recent Economic Trends in the Federation

Category	Measurement	1999 (1998)	Month to month	year to year
Industrial Production	Index	10.6 % (23.8%)	- 8.2 % (Jan 00)	9.3 % (Dec)
Construction activity	Effective hours worked	-8.4 % (17.5%)	- 20 % (Dec)	-22 % (Dec)
Electricity production	Index	1.4 % (13.6%)	15.4 % (Jan 00)	- 10.8 % (Dec)
Goods transported by road	ton-km	-9.5 % (21.4%)	8.4 % (Dec)	9.3 % (Dec)
Forestry production	m3	13 % (19.8%)	-43 % (Dec)	-30.2 % (Dec)
Retail price index	Index	-0.9 % (5.1%)	0.4 % (Jan 00)	-1% (Dec)
Net wages	KM	13.8 % (23.8 %)	8.6 % (Dec)	8.1 % (Dec)
Net wages (average)	KM (absolute figures)	374 (329)	386 (Dec)	
Employment (average)	Number (***)	407,754 (395,445)	410,104 (Dec)	
Unemployment (average)	Number (***)	262,971 (240,100)	261,793 (Dec)	
Imports (Value : US\$) (1)			-24.2 % (*)	18.2 % (**)
Imports (Value : KM) (2)	Million KM	2,431 (2,120)	26.1 % (*)	6.3 % (**)
Import excise on oil products	KM	1.4 % (12.4%)	-29.4 % (Dec)	-8.4 % (Dec)
Tax revenue (2)	Million KM	1750.8 (1672.5)	7 % (****)	13.4 % (****)

Notes :

(*) Q4-99 compared to Q3-99

(**) Q4-99 compared to Q3-98

(***) Employment includes 'waitlisted' while unemployment does not include the 'waitlisted'

(****) Q4-99 compared to Q3-99

(*****) Q4-99 compared to Q4-98

(1) Source : Federation Institute of Statistics

(2) Source : CAFAO

Republika Srpska. The situation turned out to be gloomier in the RS. Industrial production advanced by only 1.6% in 1999 compared to 1998. The Kosovo crisis cannot be the whole story behind this dismal performance as industrial production in the fourth quarter of 1999 was 8% lower than the level observed in the same period of 1998. However, construction activity, production of the electric power industry and forestry production still showed significant increases.

number and date of invoice, number and data from the purchase order, number and date of bill of lading and registration plates of the vehicle transporting the commodities). The following documents are to be attached to the report : a certified photocopy of the court registration decision, a photocopy of the issued or received invoice, a photocopy of the delivery form for the issued or received commodities, certified and signed by the recipient of commodities or the recipient of services. Clearly, this Decree is in contradiction with the principle of a *single* economic space.

Public Revenue was 20% higher in 1999 than in 1998. Higher revenue collection was entirely achieved in the second half of 1999 when revenue was 75% higher than in the first half of 1999 and 20% than in the corresponding period of 1998.

The under-performing industrial sub-sectors in the RS were: food processing (-38.1%), textiles (-23.3%), wearing apparel (-11.7%), finished wood products (-14.5%), machinery (-15.7%), electrical machinery (-16.2%), transport equipment (-22.1%), basic chemical products (-11.2%), processing of chemicals (-11.0%), rubber (-11.6%).

The few performing industrial sub-sectors were: fabricated metal products (+6.2%), building material (13.8%), beverages (+15.3%), animal feed (+28.1%).

Net wages increased 53.4% in 1999 compared to 1998.

The level of retail prices was 15.1% higher in 1999 compared to 1998. However, price inflation in 1999 was halted. In the last twelve months until January, prices increased by only 0.3%.

Table 2 : Recent Economic Trends in the RS

Category	Measurement	1999 (1998)	Month to month	year to year
Industrial Production	Index	1.6% (23.5%)	19.9% (Dec)	-7.3% (Dec)
Construction activity	Effective hours worked	14.6% (34.9%)	10.5% (Dec)	10.8% (Dec)
Electricity production	Index	15.6% (n.a.)	20% (Dec)	-10.9% (Dec)
Goods transported by road	ton-km	-6.4% (20.8%)	-25.4% (Dec)	-29.3% (Dec)
Forestry production	m3	20.1% (-4.8%)	-30.3% (Dec)	-13.1% (Dec)
Retail price index	Index	15.1% (37.9%)	0.6% (Jan 00)	0.3% (Jan 00)
Net wages	KM	53.4% (61.9%)	18.3% (Dec)	43.8% (Dec)
Net wages (average)	KM (absolute figures)	216 (141)	272 (Dec)	
Employment (average)	Number		250,000 (Jan 99)	
Unemployment (average)	Number (*)	145,030 (142,834)	149,214 (Sep)	
Imports (Value : KM) (1)	Million KM	1,589	-6.1% (**)	
Import excise on oil products	KM	-30%	10% (Dec)	-61.6% (Dec)
Public revenue (2)	Million KM	521.2 (434.0)	11.4% (**)	43.0% (***)

Notes :

(*) The RS Statistical Institute uses the concept of 'Persons Seeking Employment' (registered at the Employment Bureau); 'waitlisted' are thus excluded from the count. The figure of 145,030 unemployed refers to the first half of 1999 only.

(**) Q4-99 compared to Q3-99

(***) Q4-99 compared to Q4-98

(1) Source : Customs Administration

(2) Source : CAFAO

Table 3 : Recent Trends in Money Supply and Trade in BiH

Category	Unit	1998	month to month	year to year
Broad Money (M2) (*)	KM		- 0.9% (Sep-99)	30.6% (Sep-99)
Money (M1) (*)	KM		25.2% (Sep-99)	119.4% (Sep-99)
Imports (**)	US\$	5.5%		15.4% (***)
Exports (**)	US\$	32%		22.2% (***)

Notes :

(*) Source : Central Bank (CBBH)

(**) Source : IMF, Direction of Trade Statistics (excludes FRY data)

(***) Q4-98 compared to Q4-97

II. National Income and Economic Activity

A. National Income

GDP estimates for 1999 are probably due for June-July 2000. In 1998, nominal GDP per capita increased by 22.5%, in the Federation, and by 9.7% in the RS.

Annual GDP per capita in BiH reached US\$ 1,089 in 1998, one-half of the pre-war level. Thus, BiH just manages to belong to the league of lower middle-income countries.

The industrial and mining sub-sectors account for 22.4% of Value Added in the **Federation**, which is a significant decrease compared to the 37.3% recorded in 1990 (former Republic of BiH). By contrast, the share of trade and government/education/health care have significantly increased (from a combined 25.4% of total value added in 1990 to 36.6% in 1998).

In 1998, the share of value added in gross output was 47.8%. In 1990, this share was 46.1%. In other words, the material efficiency of production has hardly improved.

The industrial and mining sub-sectors account for 24.7% of Value Added in the **Republika Srpska**. The share of trade in total value added is 9.6% compared to 17.1% in the Federation.

On the expenditure side, statistics are virtually absent. However, according to official data, World Bank, and IMF statistics³ investment (1998) amounted to 38% of GDP (of which 20% was Public Investment) and consumption amounted to 99% of GDP. Public Sector Expenditures amounted to 52% of GDP. As Public Revenue reached 32% of GDP, external financing covered by external financing.

According to **Federation** data for 1998, gross fixed capital formation (GFCF) in agriculture/forestry and fishing amounted to only 0.6% of Federation GDP. GFCF in manufacturing and mining amounted to 4.4% of GDP. Figures for electricity sub-sector are 4.8%, trade 4.1% and transport/communication 3.1%.

³ Reported in "Bosnia and Herzegovina : Enterprise and Bank Privatization Adjustment Credit", WB, June-1999.

Table 4 : GDP

Legal Entity	Unit	1995	1996	1997	1998	1999
BiH						
Nominal GDP	million KM	2,873	4,189	5,808	6,970	7,935 (est.)
Nominal GDP per capita	KM	785	1,149	1,591	1,884	
GDP per capita growth	%		46.4%	38.5%	18.4%	
Current Account deficit	% of GDP	9.6-10.2%	26.9-27.2%	30.6-38.8%	25.5-29.4%	
Federation						
Nominal GDP	million KM	1,962	3,049	4,189	5,133	
Nominal GDP per capita	KM	868	1,353	1,862	2,281	
RS						
Nominal GDP	million KM	911	1,140	1,619	1,837	
Nominal GDP per capita	KM	651	814	1,156	1,268	

Notes :

- Federation population estimate for 1998 : 2.25 million
- **Sources** : Statistical Institutes and World Bank

What are the growth perspectives for BiH? The World Bank sees another three years of double-digit GDP growth for BiH. By contrast, analysis carried out at the *Private Sector Development Task Force* resulted in a much gloomier picture. Economic Freedom in BiH is clearly repressed. This repression affects both domestic savings *and* the efficiency of investments. Based on cross-country empirical evidence of the relationship between Economic Freedom and domestic savings and investment efficiency, the PSD-TF predicts single-digit GDP growth rates, even if the trend towards “markets liberalization” continues. In fact, the growth rate is converging towards the long-term *natural* rate than one can expect for a lower middle-income country with excessive repression of Economic Freedom.

Table 5 : Growth Scenarios for BiH

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Current Account Deficit (*)								
IMF-WB estimates (% of GDP)	55	50	34	24	19	16	10	4
Investment (% of GDP)								
IMF-WB estimates	41	42	38	33	33	32	28	25
Base scenario of PSD-TF					28	26	23	19
"liberalization" scenario					31	29	26	23
Real GDP growth (% p.a.)								
IMF-WB estimates	69	30	18	8	14	14	10	5
Base scenario of PSD-TF					6.1	4.5	3.2	2.3
"liberalization" scenario					7.6	5.8	4.3	3.4

(*) excluding interest and official transfers

PSD-TF : Private Sector Development Task Force Secretariat

B. Economic Activity

In 1998, a one-percent growth in the Industrial Production-index coincided with approximately 0.8 % growth in GDP. Considering that Industrial Production has been disappointing (+ 10.6 % in the Federation and 1.6 % in the RS), we expect that GDP growth will be in the single-digits for 1999 (7-9 %) in the Federation and under 5 % in the RS (depending on how well the agricultural sector performs in 1999).

Three graphs shown on the following pages, present:

- Index of Industrial Production
- Electric Power Industry
- Food Processing (RS) and Trade (in food products/Federation)

These graphs confirm that there exists quite some seasonal pattern in the data. They also illustrate the Kosovo-effect (April and May). Thereafter, growth in industrial production recovered in the Federation, but not so in the RS. Interesting also, industrial production in the RS shows a persistent pattern of high activity in December and extremely low activity in January (not unlike the pattern observed in former socialist economies).⁴

Corporate performance in BiH is not uniform. Private businesses contribute relatively more to profits generation than do Public Enterprises.

⁴ The RS counts a large number of holidays in January.

In the **Federation**, 25 companies accounted for half of all (accounting) losses in the first half of 1999. In 1998, Public Enterprises accounted for 73.6% of all accounting losses incurred whilst private companies contributed for 58.4 % of all profits generated. In the same year, Public Enterprises generated KM 3.6 billion of Sales revenue and incurred KM540 million of accounting losses (corresponding to over 10 % of GDP). We estimate that against each KM1 of *net* wage paid out to workers (private and public sector), KM0.3 is incurred in *net* losses.

In the **RS**, net losses recorded in 1998 (all enterprises) were KM483 million, which is equivalent to 23.6 % of output. Net losses *per employee* were KM3,500; this compares with an average monthly net wage of KM146. Just 28 companies accounted for 52% of losses (first half of 1999). Employment at these 28 companies is 20,092. Losses per employee average at least KM10,000 per year (well above annual net wages). Enterprises in the Banja Luka region were responsible for 30% (of these 52% of losses).

Box : losses in the economy

What is the relative importance of losses? Based on 1998 data, the following could be inferred:

	<u>Sector share in GDP</u>	<u>Gross losses as % of sector Value Added</u>
<u>Federation</u>		
Industry and Mining	22.4%	33 % ⁵
Agriculture	10.8%	18%
Transport and telecommunications	8.8%	21 % ⁶
Housing-Public utilities	2.5%	⁷
Health care and social care	4.6%	7.7% ⁸
<u>RS</u>		
Industry and Mining	24.7%	98%
Agriculture	25.2%	1.4%
Transport and telecommunications	6.2%	6.6%
Banking	5.9%	7.6%
Health care and social care	4.0%	⁹

⁵ Coal mining accounts for 29.1 % of the sector's gross losses whilst the Elektroprivreda are responsible for 20.9 % of gross losses.

⁶ Railways account for 84.3 % of the sector's losses. Furthermore, Post and Telecommunications account for 86.1 % of the sector's gross profits; for 1 KM of revenue, 0.23 KM of profit is generated (illustrating the monopoly position the providers enjoy in their territory).

⁷ "Sarajevo-Gas" incurred 41 million KM of losses or 32.6 % of the sector's Value Added.

⁸ Health cares only.

⁹ The deficit of the Health Insurance Fund (excluding Budget support) is equivalent to 1.2% of GDP; regular contributions cover only 78% of expenditures.

How does **entrepreneurship** fare in BiH? In the Federation there exist 1.22 registered companies per 100 population (this ratio is normally 5-6 in market economies). In the RS, there exist 1.5 companies per 100 population. A number of these companies, private as well as public companies are no longer operational. Table 6 shows how business registration evolved between 1997 and 1998. "One-man businesses" account for the larger part of the increase in registered private businesses.

Table 6 : Registered Businesses (in the Federation)

	Agriculture Forestry Fishing	Mining Manufacturing Electricity/gas	Construction	Tertiary sector	Total
1997					
State ownership	28	144	64	307	543
Social ownership	70	268	64	379	781
Private ownership	394	3,383	2,595	18,822	25,194
<i>of which self-employed</i>	233	1,981	1,678	10,725	14,617
Cooperative/Mixed ownership	71	284	108	595	1058
Total	563	4,079	2,831	20,103	27,576
1998					
State ownership	32	171	73	210	486
Social ownership	33	204	50	256	543
Private ownership	508	4,067	2,846	21,672	29,093
<i>of which self-employed</i>	338	2,629	1,985	13,741	18,693
Cooperative/Mixed ownership	85	384	136	608	1,213
Total	658	4,826	3,105	22,746	31,335

Source : Statistical Yearbook (Federation)

A final note about **agriculture**. Agriculture production in BiH is well below its potential, and productivity is less than half of the levels achieved in Western Europe. "To address these issues the strategy will promote the adoption of improved management systems as the basis for increasing the efficiency and profitability of production, and so farm output and farm income. ... Effective development of marketing, processing and agri-business is the basis for building competitive, demand-driven commercial agriculture. This infrastructure will be established by developing strong marketing institutions, agri-business enterprises and agro-processors; and by promoting the formation of producer associations to link producers to market outlets and increase marketed surplus. Rapid privatization of state-owned marketing agencies and agro-processors, in a viable form, is the starting point for this process." ¹⁰

¹⁰ *Medium-Term Agriculture Sector Strategy*, FAO, August 1999.

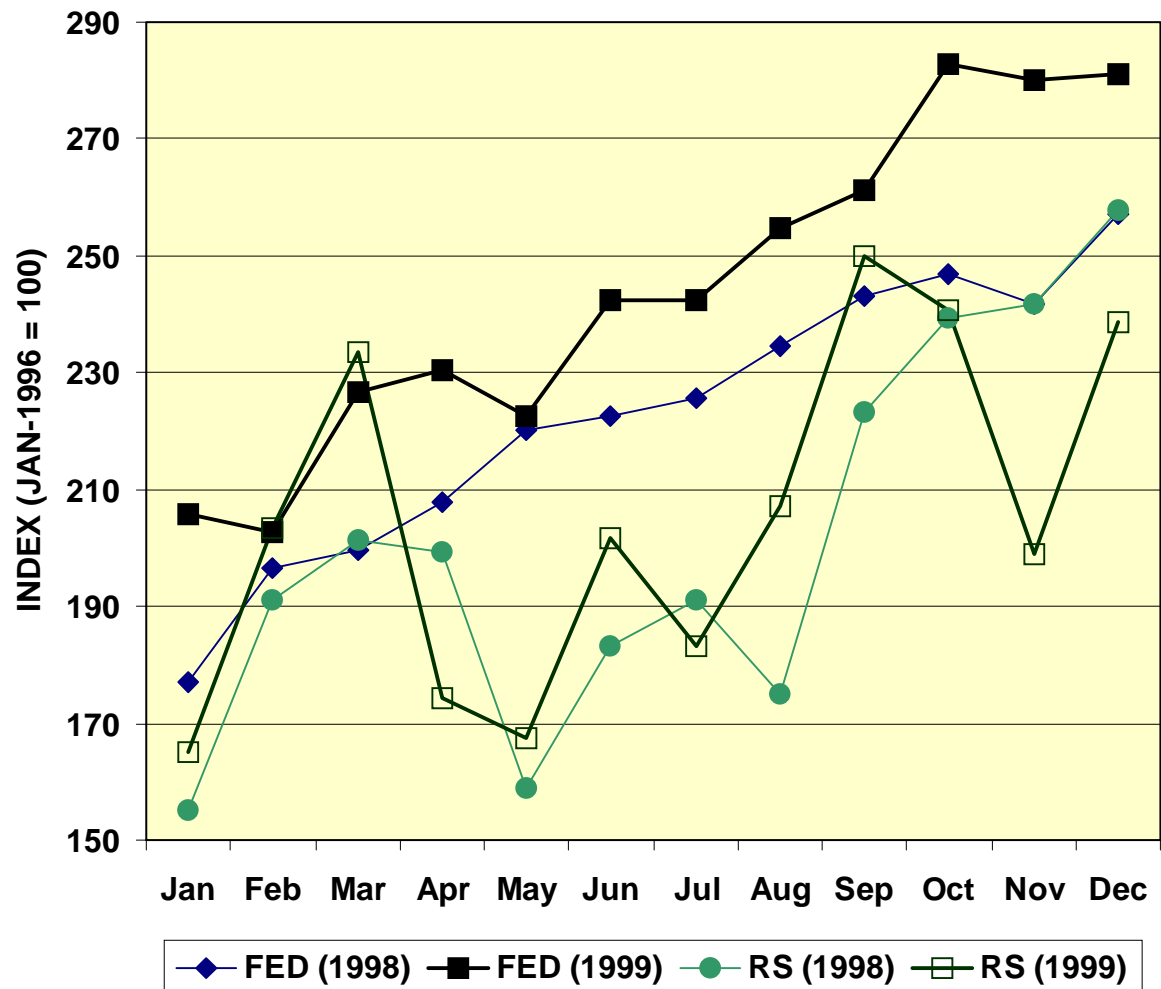
Box : agriculture in BiH

Less than half of Federation area is classified as agricultural land; of this, less than 20 percent is suited to intensive agriculture, most of it in lowland river valleys. The land base for agriculture is thus very limited in both quantity and quality. Natural water resources are abundant. Before the war, around 300 large state farms cultivated 6 percent of agricultural land and accounted for 10 percent of production. A further 570,000 small-scale private farms accounted for the remaining resource use and production. Only 16 percent of these private farms relied wholly on farms income (the other 84 percent being part-time farmers or rural residents).

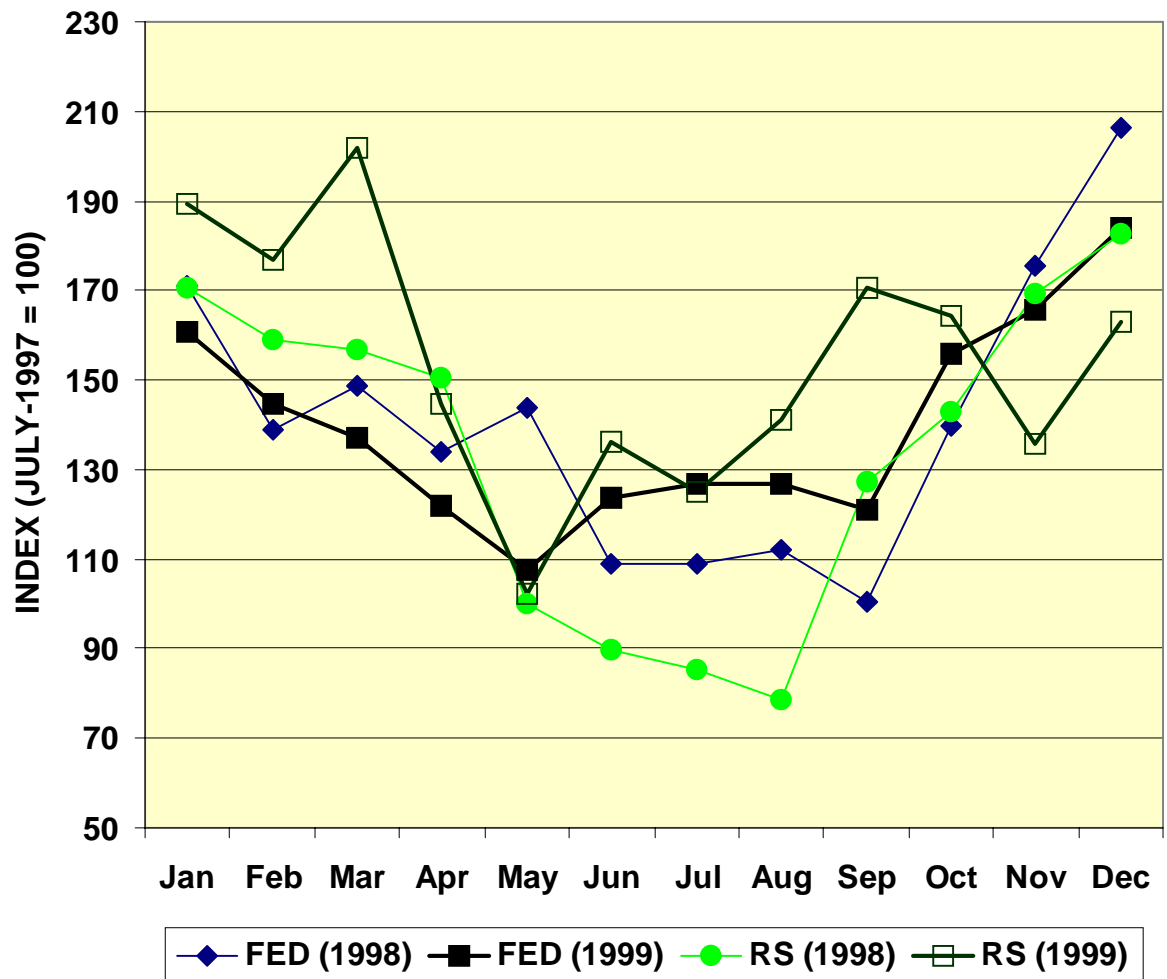
In the RS, just over half of the area is classified as agricultural land; of this, 45 percent is of medium quality and 25 percent is suited to intensive production. Natural water resources are abundant. A handful of large state farms cultivated 12 percent of agricultural land and accounted for 20 percent of production, while 258,500 small-scale private farms accounted for the remaining resource use and production.

Source : FAO

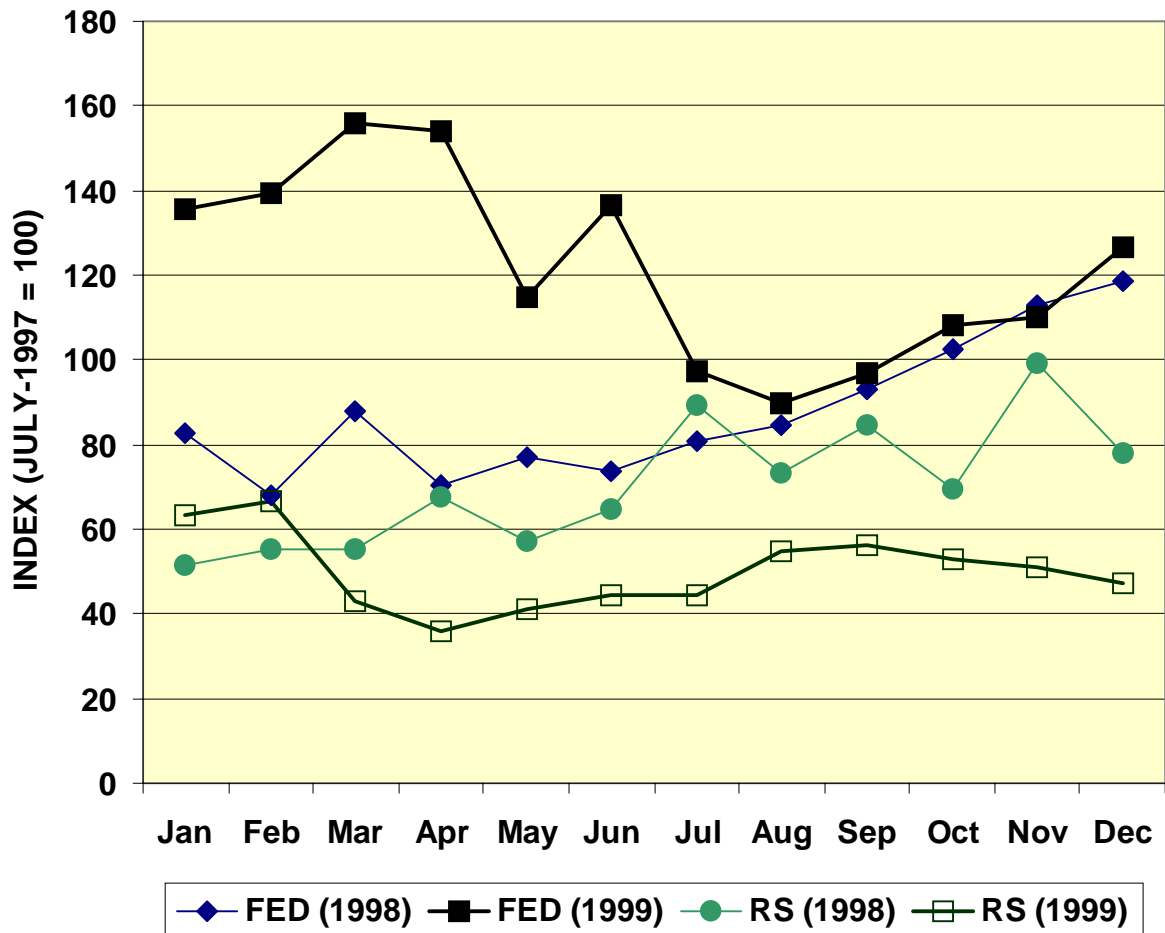
INDEX OF INDUSTRIAL PRODUCTION



INDEX OF ELECTRIC POWER PRODUCTION



TRADE IN AGRICULTURAL PRODUCTS (FED); FOOD PROCESSING (RS)



III. Foreign Trade

Accurate measurement of BiH trade flows has been one of the most difficult areas of BiH statistics. The RS Statistical Institute does not publish official data on trade flows – though these data are available with the Customs Department¹¹ --, and the Federal Institute for Statistics experienced serious difficulties in collecting data. Other than the trade data from the Federation Institute of Statistics, there are two sources of trade statistics: CAFAO and the IMF Direction of Trade Statistics (DOTS).

Official Federal Institute for Statistics data is based on reports from customs houses in the case of imports and from enterprises in the case of exports. CAFAO estimates the value of trade flows using data on receipts of the 1% customs evidencing charge. Both sources are incomplete but the CAFAO data are felt to be more accurate.

The IMF uses trade reports from BiH's trading partners to estimate imports and exports. The advantage is that a picture is drawn about total BiH imports and exports. The weakness is that trade with Yugoslavia is not included at all, which is a serious gap since the RS, at least until the Kosovo crisis, had significant trading relations with the FRY. As a result, for 1998 the DOTS probably underestimated imports by US\$475 million and exports by US\$217 million. In other words, using DOTS as the starting point and adjusting for the estimated BiH-FRY trade, total imports would have been worth US\$2,983 million USD and exports could have been US\$716 million. Thus, we estimate the 1998 Balance of Trade deficit to be in the neighborhood of US\$2,267 million¹², significantly higher than either the World Bank or IMF estimates (which are reported in EBRD).¹³ Assuming that these estimates are somewhat accurate, then the 'true' Balance of Trade deficit in 1998 was as high as 58% of GDP whereas the openness of the economy (measured by total foreign trade divided by GDP) reached 95%.

Exports from the **Federation** progressed significantly in 1999, though starting from a very low basis (+ 66.6% in the second half of 1999 compared to the same period in 1998). Imports increased 14.7% in 1999 compared to the level of 1998.

By contrast, the fallout of the severed trading relations with the FRY has meant a dramatic drop in both exports and imports of the **Republika Srpska**, in the first half of 1999. Trade figures picked up sharply in the second half of 1999: exports were 67% higher compared to the first half and imports were 46% higher. According to Customs authorities data total imports (1999) amounted to KM1,589 million and total exports reached KM425 million.

Whereas imports from Yugoslavia accounted for 75% of recorded imports in 1998 (RS), this percentage had dropped to only 23% in 1999 (and just 20% in November-December 1999). Meanwhile, Slovenia and Croatia accounted for another 15% of imports. On the other hand,

¹¹ We are reporting RS statistics 'as is' even though serious doubts remain about data integrity.

¹² Even without counting 'illegal (unrecorded) imports'.

¹³ EBRD, in "BiH 1999 Country Profile" (March 1999) reports a Balance of Trade deficit for 1998 of US\$ 1,643 million.

Yugoslavia was still the destination of 43% of RS exports (against about 80 % in 1998). Italy is the second largest destination for RS exports (16.5%).

The (official) estimated **Current Account** deficit for 1998 reached US\$1.1 to 1.2 billion. The Current Account (CA) deficit (*before official transfers*) amounts to 35% of GDP. At the end of 1997 total external debt amounted to 127% of GDP.

According to Central Bank data, the Current Account deficit, for the first nine months of 1999, reached KM2.44 billion (*including transfers*), which is equivalent to \$1.33 billion.

A final note about **foreign investment**. In the period September 1998 to August 1999 (twelve months), foreign partners in FDI projects contributed KM 205.5 million in *registered* investment (\$112 million). Were this investment effectively to materialize, then such an amount would be equivalent to about 6% of the Current Account deficit.

Box : foreign investment in BiH

From May 1994 until September 1999, 1741 investment projects were registered, 124 projects of which involve investment exceeding 100,000 DM. Total investment amounts to 618.1 million DM of which foreign partners contribute 340.3 million DM. It is believed that FDI data are incomplete as not all contracts in the RS and HDZ (Croat) controlled areas are registered.

Investors from Croatia (384), Germany (237), Slovenia (232) and Turkey (173) count for over half of all projects but only 16 % of foreign capital. By contrast, 10 projects with involvement from Kuwaiti investors amount to 219.4 million DM of foreign capital (79 % of total). Standing out is a 161.8 million DM capital investment by the Kuwait Consulting and Investment Company (KCIC) in the joint venture BH Steel Company (Zenica). Mainly thanks to the latter, a) over two-thirds of registered investment is in productive activities against 8.1 % in trade, and, b) 56.6 % of registered investment is in the basic metal industry.

Comparative foreign investment data :

	<u>cumulative</u>	<u>per capita</u>	<u>period until</u>
Slovenia	\$ 4.1 billion	\$ 2050	December 1998
Croatia	\$ 2.2 billion	\$ 459	September 1999
Bulgaria	\$ 2.4 billion	\$ 286	June 1999
Hungary	\$ 20.5 billion	\$ 1941	July 1999
Romania	\$ 4.2 billion	\$ 185	August 1999
Poland	\$ 40 billion	\$ 1033	August 1999

Source : Central European Economic Review (December 1999)

Table 7 : Foreign Trade (BiH) (million US\$)

Period	Exports Total	Imports			
		Total	EU	CROATIA	SLOVENIA
1997	372	2,377	943	714	317
1998	491	2,508	1,025	740	350
Q1-97	68	609	215	177	73
Q2-97	89	563	238	157	83
Q3-97	107	582	232	192	77
Q4-97	108	624	258	187	85
Q1-98	106	530	219	154	69
Q2-98	110	589	250	171	78
Q3-98	143	669	255	222	95
Q4-98	132	720	302	194	108
Q1-99	113	543	217	133	83
Q2-99	117	617	250	167	100

Source : DIRECTION OF TRADE STATISTICS (IMF)

Table 8 : Foreign Trade (Federation) (x US\$1,000)

Period	Exports Total	Imports				Imports (x KM1,000) ***
		Total	EU	CROATIA	SLOVENIA	
1997	108,683	1,544,970	685,717	295,935	211,664	2,922,680
1998	315,816 *	2,120,297 *	638,003 *	767,466 *	302,591 *	3,515,052
1999	518,081	2,431,152	1,033,910	525,680	314,603	3,697,404
Q1-97	17,600	183,948	64,579	34,233	29,295	596,905
Q2-97	25,503	594,788	299,072	104,034	73,357	717,851
Q3-97	27,206	377,596	160,514	82,390	51,996	788,051
Q4-97	38,374	398,638	161,552	75,278	57,016	819,873
Q1-98						682,616
Q2-98	153,557 **	957,751 **	288,506**	335,126**	133,208 **	819,391
Q3-98	100,982 *	559,235 *	165,271 *	70761 *	81,096 *	920,395
Q4-98	97,277 *	603,311 *	184,226 *	361,579 *	88,287 *	1,092,651
Q1-99	68,851	324,941	95,755	92,070	50,523	728,874
Q2-99	119,448	452,431	154,274	139,717	73,954	884,899
Q3-99	195,149	940,726	460,872	174,100	95,359	921,729
Q4-99	134,633	713,054	323,009	119,793	94,767	1,161,903

Source : Federal Institute of Statistics (US\$ figures)

Note : * = new data from Customs ** = Q1 and Q2 combined (new data from Customs)

*** Source is CAFAO (KM figures; derived for customs evidence)

Table 9 : Foreign Trade (RS)

(million KM)

Period	Exports	Imports
Jan-99	57.2	149.4
Feb-99	19.3	84.0
Mar-99	13.7	81.5
Apr-99	14.1	63.5
May-99	18.8	73.1
Jun-99	36.2	195.2
Jul-99	46.8	215.5
Aug-99	37.4	107.7
Sep-99	78.8	162.6
Oct-99	42.8	166.6
Nov-99	27.7	139.0
Dec-99	32.6	150.8

Source : Customs Administration

Table 10 : Current Account

(x1,000 KM)

Category	Federation <i>Jan-September 1999</i>	RS <i>Jan-September 1999</i>
Exports (goods; f.o.b.)	486,959	322,298
Imports (goods; f.o.b.)	2,236,353	1,132,586
Balance of Trade	-1,749,394	-807,925
Services (net)	-90,863	-11,595
Current transfers	204,970	13,958
Current Account	-1,635,287	-807,925

Source : CBBH, Bulletin No3-1999

IV. Labor Market

Population and labor market data are no better than the statistics on foreign trade. The “true” unemployment rate is hard to calculate since, in the absence of a census and household surveys, both the numerator and denominator are guesses, at best.

The Federal Institute for Statistics estimates the Federation **population** at 2,243,789 (as of December 31, 1998). The RS Statistical Institute estimates the RS population at 1,448,537. Accordingly, the BiH population is estimated at 3.69 million, compared to UNHCR’s 1997 estimate of 3.9 million.

In the **Federation**, the level of registered **employment** was 3.1% higher in 1999, compared to 1998. As a reminder, industrial production increased 10.6% in the same period. Registered unemployment was 261,793 (December 1999) against 256,487 one year earlier. ‘Waitlisted’ persons were 53,912 in December 1999, a decrease from 70,961 one year earlier.¹⁴ ‘Waitlisted’ persons are recorded as registered employed; therefore the number of full-time or ‘non-waitlisted’ registered employed increased from 336,086 (December 1998) to 356,192 in December 1999, or + 6%.¹⁵

The unemployment rate is estimated at around 30% (both for the Federation and RS). Still, in the Federation, net wages increased 13.8% (1999).

In the **Republika Srpska**, data on employment are extremely scarce. The latest indications are that unemployment was rising (149,214 unemployed in September 1999 against 142,913 one year earlier). Nevertheless, net wages increased by 53.4% in 1999, compared to 1998.

How rigid is the labor market? The following observations point at labor market rigidities:

- net wages continue to increase significantly in spite of a high unemployment rate (even though one may rightly wonder how representative reported ‘net wages’ really are);
- real unit labor costs (in the Federation) remain virtually constant (when *seasonally* adjusted) since 1997; taking 1997 as the base year (Index = 100), real unit labor costs average 99.6 in 1998 and 95.5 in 1999¹⁶ ;
- sectoral differences in net wages are not large ; the sector paying out the highest net wages reports net wages 205% of the net wages in the lowest-paying sector (Federation, fourth quarter of 1999;¹⁷

¹⁴ ‘Waitlisted’ are defined as workers “... for whose work there is temporarily no need due to the decreased scope of work *during a state of war*...” (1992).

¹⁵ Allowing for productivity increases, this increase in full-time employment could indicate a GDP-increase of about 8 %, provided that the relative size of the gray economy did not increase.

¹⁶ The index of *real unit labor costs* is constructed as follows : real product wages deflated by productivity. Real product wages are nominal gross wages deflated by industrial producer prices. Productivity is industrial production (index) deflated by industrial employment. The index therefore roughly measures the change in the relative wage share and, *ceteris paribus*, the change in “profit margins”.

- regional differences in net wages paid out are also not large; in the Federation, net wages in the Canton with the highest average is only 41% higher than in the Canton with the lowest average net wages (average for 1999);
- reported net wages paid to the public administration exceed *average* net wages paid by 34% (average for 1999) in the Federation and by 29% (November 1999) in the RS.^{18 19}

In spite of low adult illiteracy rates (3.4% for men, but 16.4% for women, 1991²⁰) and high enrolment rates in primary, secondary and tertiary education²¹, a serious **qualifications mismatch** exists. Of the 265,453 unemployed persons registered in the Federation (November 1999), 45% have no or limited qualifications. By contrast, only 2% of the unemployed hold a degree from university or Higher Schools (post-secondary education).

In the Canton Sarajevo, 50,018 persons were registered as unemployed (May 30, 1999). Of these,

- 30,889 were women;
- 30,753 were first-time employment seekers;
- 24,536 have no or only limited qualifications.

Confirming the extent of the mismatch, of all positions for which employers are submitting notices (i.e. vacancies) to the Employment Bureau, about 60% require at least a secondary school diploma.²²

Another causes for worry is the situation of the **pension funds**. The low employment ratio implies that for every pensioner (**Federation**) only 1.53 employees (including the 'waitlisted') are contributing into the pension fund.²³ In December 1999, the average pension paid out was KM176, the highest pension paid out was KM613 and the guaranteed pension was KM150.²⁴ Reportedly also, the pension payments are often several months in arrears.

In the **RS**, the average pension reached KM106.6 in November 1999. Early 1999, for every pensioner only 1.55 employees were contributing into the pension fund.

¹⁷ In November 1999, the corresponding figure in RS was 219%.

¹⁸ In the UK, earnings in public administration are practically at par with the average earnings (i.e. 1.03).

¹⁹ In 1991, civil servants (employees of SOEs not included) accounted for 15 % of registered employment. By 1998, this ratio increased to 18% in the RS (37% according to another source) and reached 31 % in the Federation. By comparison, in France, employment in the civil service is 20.2% of total employment (14.1% in Germany, 14.2% in the USA, 8.3% in Japan).

²⁰ Compared to less than 2 % in industrialized countries (men & women) and 20% for men in developing countries (37 % for women).

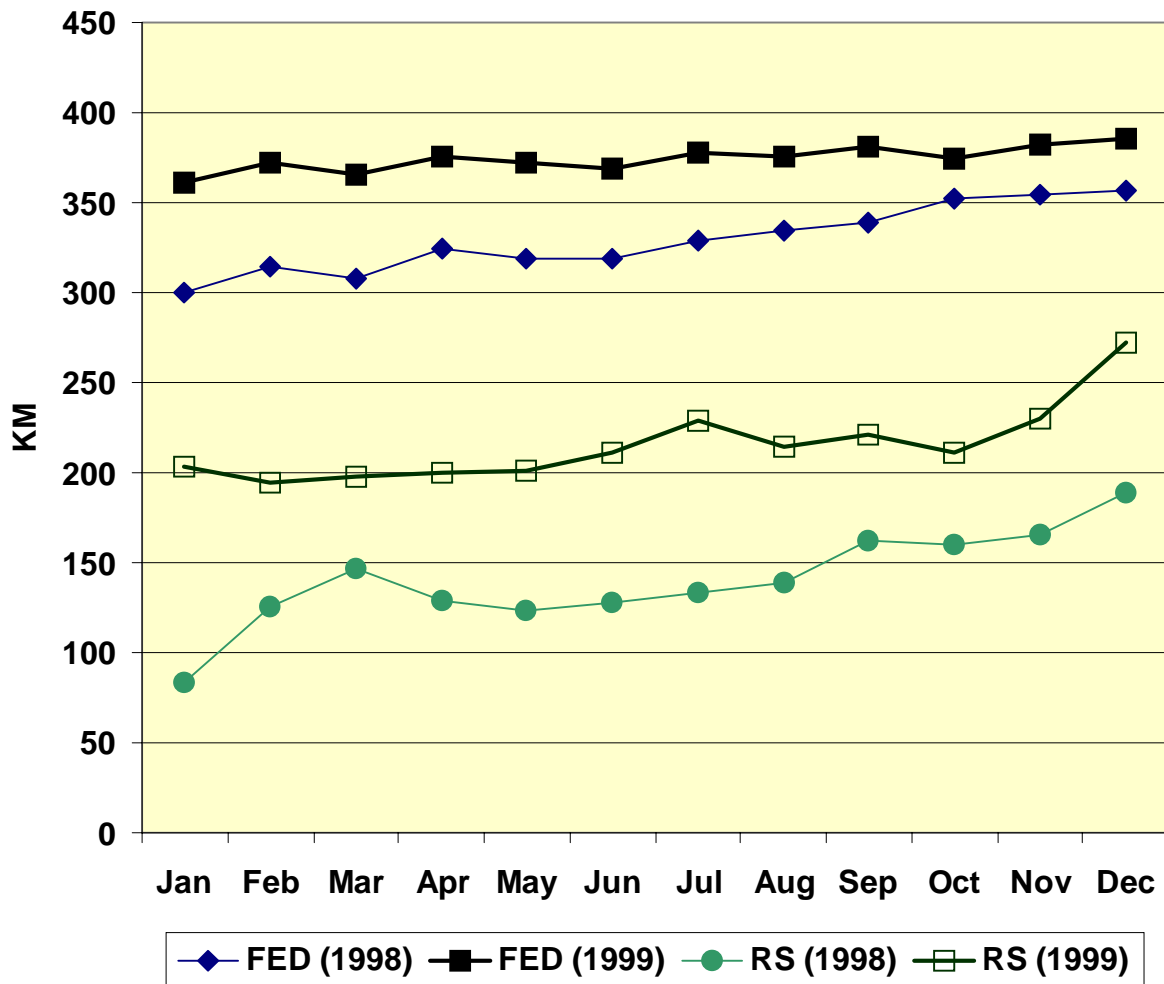
²¹ The combined enrolment rate is approximately 58% (compared to 55% for women and 64% for men in developing countries).

²² However, Employment Bureaus receive very few reports of vacancies (1306 in 1998 for the Federation)

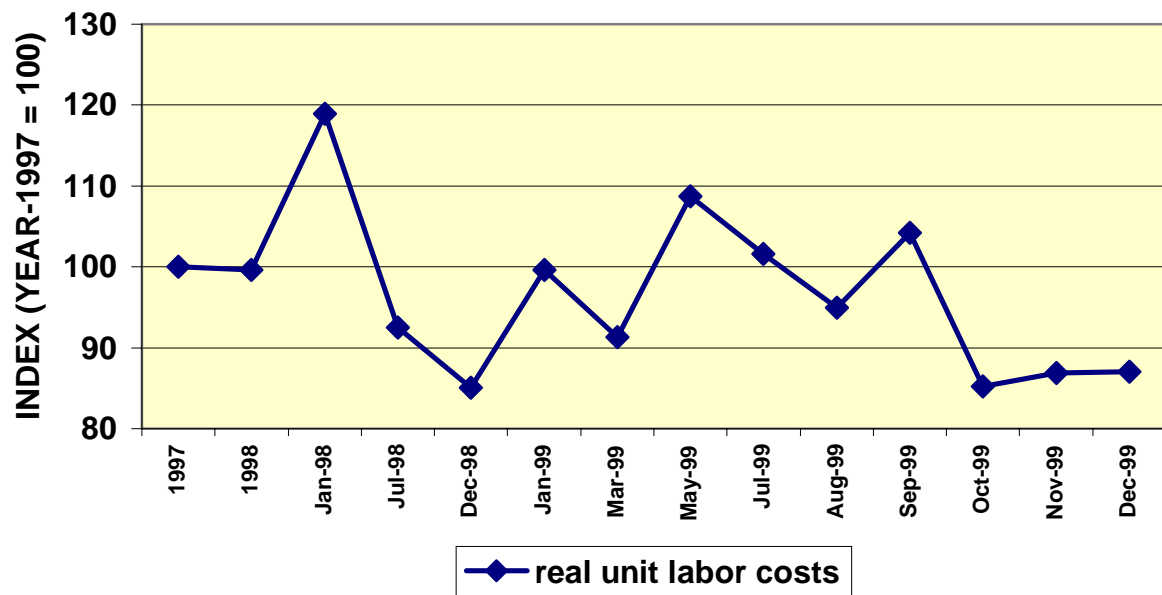
²³ The equivalent rate in the UK (1997) is 2.5.

²⁴ Though the guaranteed pension is KM 150, quite a sizeable number of pensioners continue to receive a pension less than the statutory amount. In October 1998 (Federation), the average pension paid out was KM 158, the highest pension paid out was KM548 and the guaranteed pension was KM134. (Source : Human Development Report-1998, UNDP)

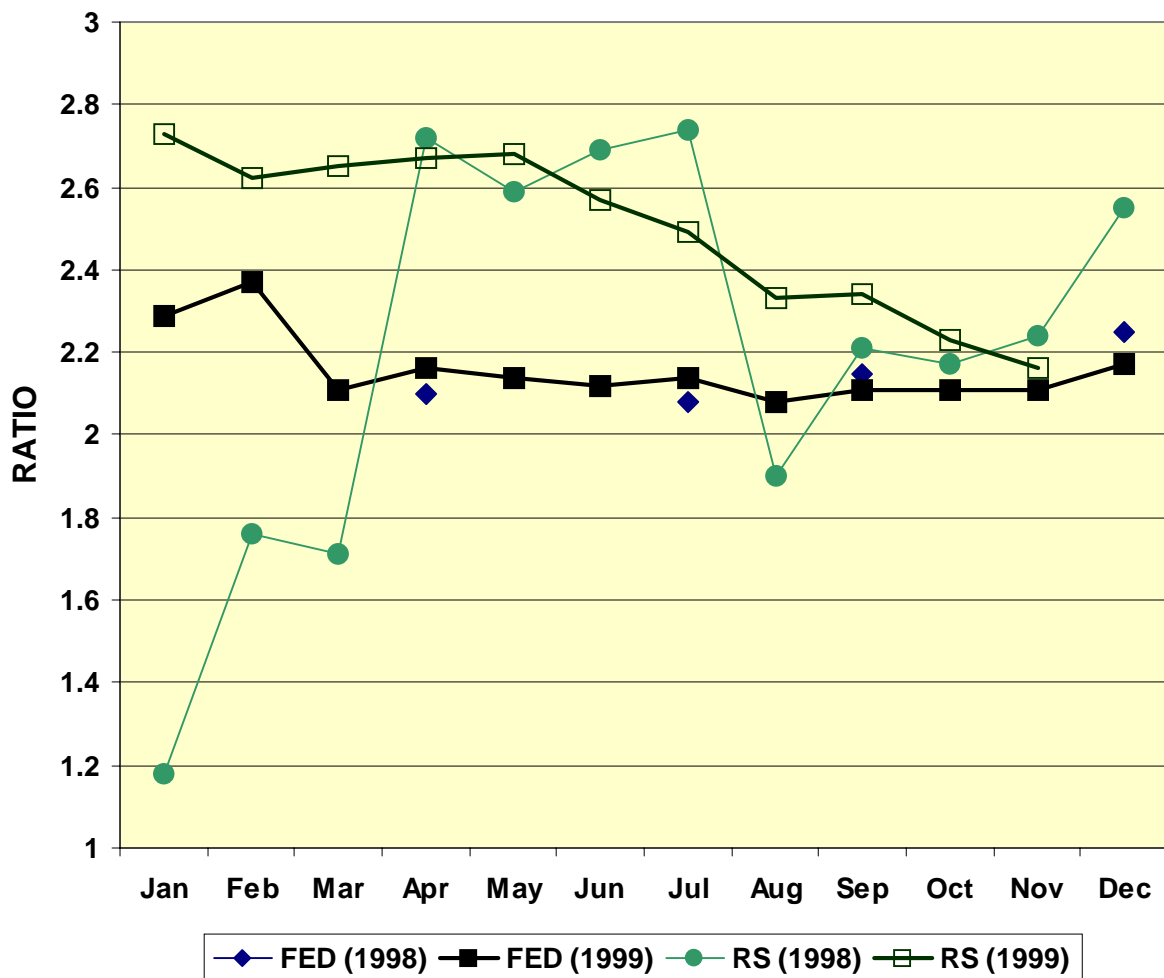
MONTHLY NET WAGES



REAL UNIT LABOR COSTS IN INDUSTRY (FEDERATION)



AVERAGE NET WAGE / AVERAGE PENSION



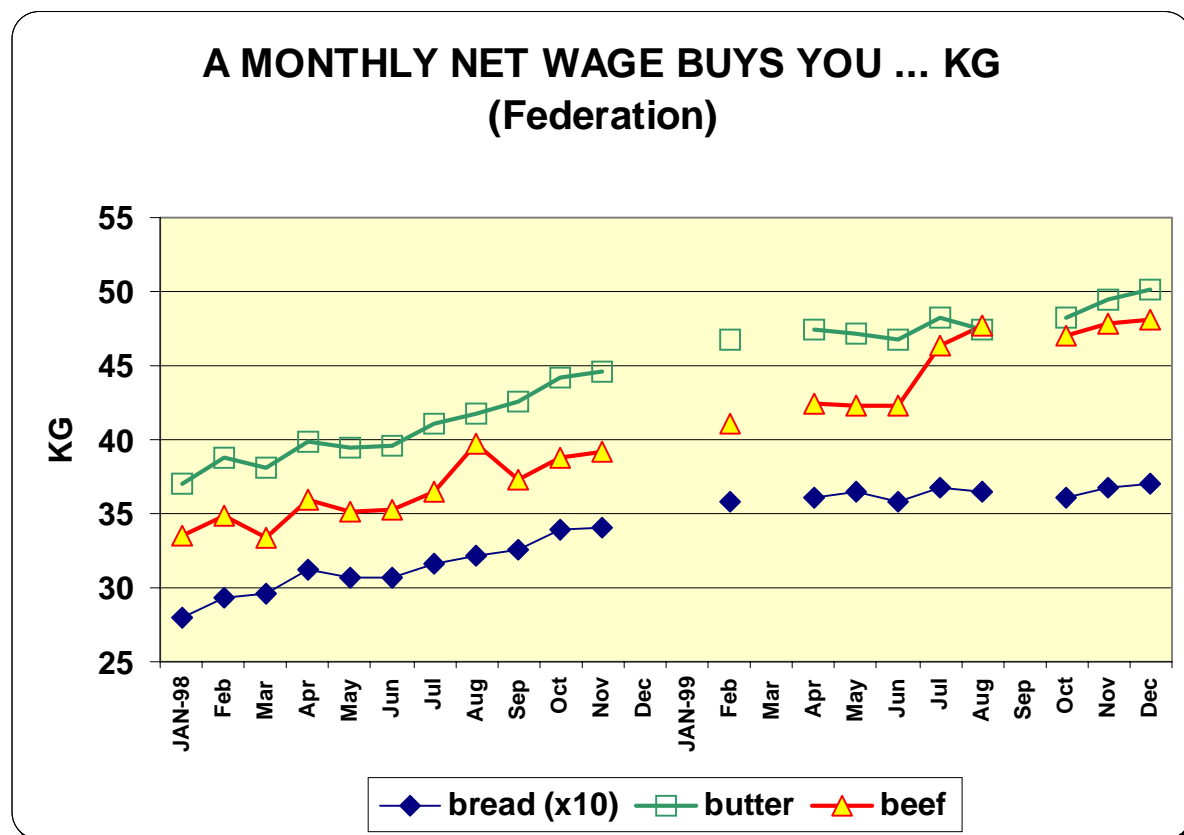
V. Prices, Wages and Exchange Rates

After a 12% price inflation recorded in 1997, inflation decelerated in the **Federation** during 1998, to 5.1%. This trend continues into 1999 with retail prices remaining virtually stable (and actually falling marginally until August before picking up again until December). January-August) by 1.4% compared to last year.

The average price level in the **Republika Srpska** increased by 38% in 1998 compared to 1997. However, this inflation was calculated on the basis of an index expressed in Yugoslav Dinar (YD); when inflation caused by the depreciation of the Dinar is taken out, inflation was actually less dramatic. Since the start of 1999, the RS Institute of Statistics computes the retail price index based on prices recorded in Konvertible Marka (KM), rather than YD prices. This index reveals that there is virtually no more price inflation in the RS since January 1999 (even though the average price level in 1999 is 15% higher than in 1998).

Wages and Purchasing Power

Instead of constructing a **real** net wages index, we calculated what an average monthly net wage could buy. In the Federation (December 1999), one monthly net wage of KM 385.6 bought 371kg of bread or 50kg of butter or 48kg of beef. This is a significant increase in purchasing

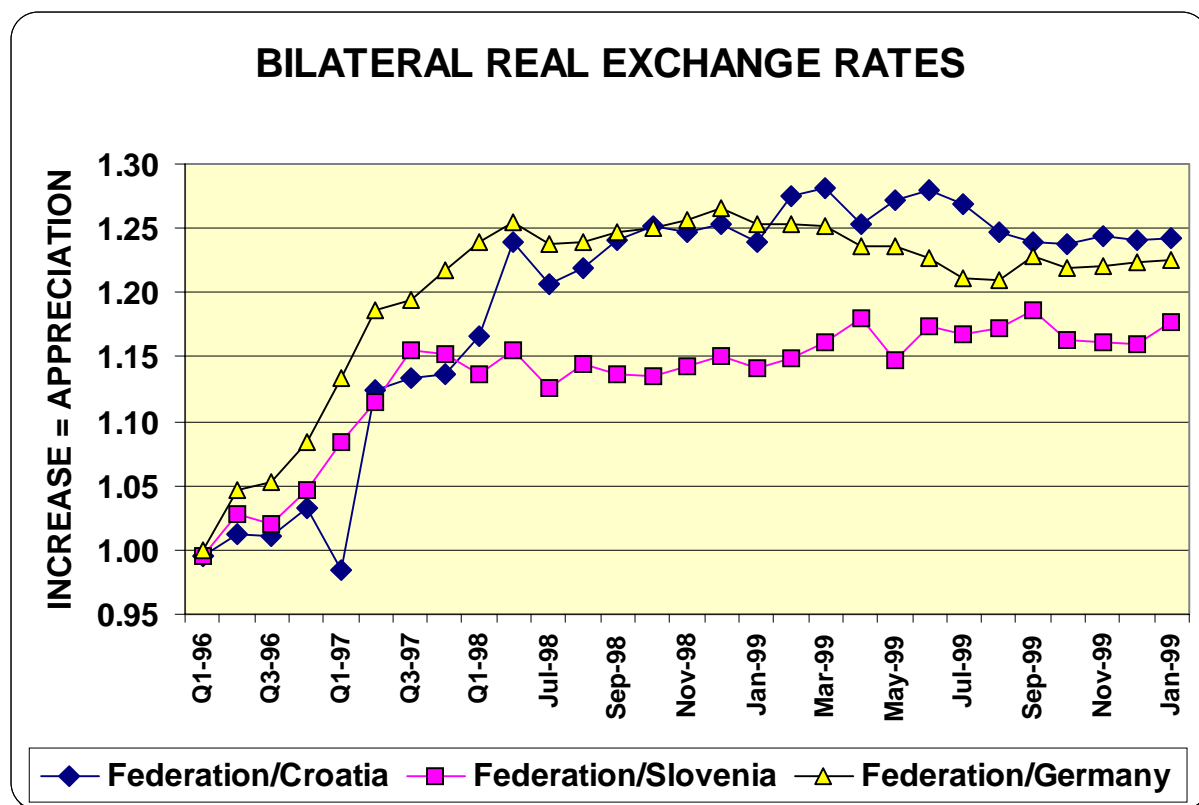


power compared to January 1998 when the monthly net wage bought 280kg of bread, 37kg of butter or 33kg of beef. This positive trend is not entirely to be attributed to increasing wages, but also to slightly decreasing prices for these three commodities.

In the RS, the average monthly net wage (expressed in YD) paid out in December 1998, bought 284kg of bread, 14.5kg of butter or 18kg of beef. In June 1999, the average monthly net wage of KM211 bought 322kg of bread, 17.9kg of butter or 20.9kg of beef. These figures demonstrate the lower wage earned in the RS as well as the different relative prices compared to the Federation.

Exchange Rates

BiH Economic Update (April 1999) introduced the Real Effective Exchange Rate (REER), i.e. the *real* exchange rate of the BiH KM versus the currencies of the Federation's trading partners. The real exchange rate affects the level of imports and exports. If the real exchange depreciates, then imports become less attractive to BiH citizens, and BiH exports become more attractive to foreign countries. If the real exchange rate appreciates, then the reverse is true. Because the nominal exchange rate of the BiH KM is fixed against the Deutsche Mark (DM), BiH authorities cannot manipulate the real exchange rate. The real exchange rate thus depends on the differential price trends only. The REER underwent little change since early 1997. The graph below shows **bilateral real exchange rates** (RER) with Croatia, Slovenia and Germany. The currency appreciated (in real terms) against the Slovenian Tolar until Q3-97, the Croatian Kuna until Q2-1998 and the DM until Q2-1998. In recent months RERs remained virtually flat.



VI. Fiscal Indicators

The government system of BiH is very decentralized, which complicates statistical data collection. Economic responsibilities of the State government are limited to areas of foreign trade policy, external debt servicing, customs policy and monetary policy (i.e. the Central Bank, which operates as a currency board). Entity governments are in charge of areas not specifically assigned to the State. Furthermore, in the Federation, substantial power is devolved to the 10 Cantons, where the Cantonal administrations are responsible for public services, education, social transfers and other matters.

The government is prohibited from taking credits from the Central Bank, or borrowing from the public or commercial banks, as that would violate the rules of the currency board, and IMF agreements. The government is thus constrained by tax and non-tax revenue, in addition to foreign loans and grants. Whenever a revenue shortfall is anticipated, budgetary expenditure needs to be revised downward.

The provision of large amounts of donor funding has facilitated a large public expenditure program while enabling BiH to maintain fiscal stability. The present level of government spending is however excessive. A major effort must be undertaken to enhance revenue mobilization by widening the tax base rather than raising tax rates, reducing public spending, improving expenditure management, re-balancing recurrent expenditures, or restructuring the Social Security System.

As the government cannot have recourse to domestic borrowing, the focus is on revenues. CAFAO's data for the **Federation** indicate an increase of 4.7% in tax revenues (1999). This positive growth was entirely achieved in the second half of 1999 (as the first half saw a decline compared to the same period in 1998). Data for the **RS** indicate an increase of 20.1% in public revenues (1999). This increase was entirely achieved in the second half of 1999 (as the first half of 1999 did not see any growth).

Overall fiscal pressure is excessive and represses business development. In spite of data collection difficulties, we estimate that **fiscal pressure** (including Social Security contributions) is about 47% (1998) in the Federation and 35% in the RS. This compares to an average of 19% in lower middle-income countries and 34% in EU countries (unweighted average).

Table 11 : Consolidated Tax Revenue (Federation)

(million KM)

DESCRIPTION	FEDERATION	CANTON	MUNICIPALITY	TOTAL
1998				
Customs Tariff Duties	304.9			304.9
Import Excises	265.7			265.7
Domestic Excises	54.9			54.9
Sales Taxes		644.3	66.0	710.3
Wage Taxes		167.2	34.9	202.1
Company Profit Taxes	10.3	66.0	2.7	79.0
Property Taxes		13.7	33.4	47.1
Other		6.2	2.5	8.6
TOTAL	635.7	897.4	139.4	1,672.5
1999				
Customs Tariff Duties	345.2			345.2
Import Excises	240.3			240.3
Domestic Excises	74.2			74.2
Sales Taxes		692.3	69.7	762.0
Wage Taxes		182.1	38.2	220.3
Company Profit Taxes	17.5	28.9	1.3	47.7
Property Taxes		13.2	36.7	49.9
Other		7.6	3.4	11.0
TOTAL	677.3	924.2	149.3	1,750.8

Source : CAFAO

Table 12 : Total Public Revenue (Federation)

(million KM)

Description	Jan-September 1999
Federation, Canton and Municipalities	1,322
Social Insurance Funds	655
Other	65
TOTAL	2,042
<i>reminder : tax revenue (Source : CAFAO)</i>	1,249

Source : CBBH

Table 13 : Public Revenue (RS) excluding social insurance

(million KM)

DESCRIPTION	
1998	
Customs Duties	89.2
Excise Duties	69.2
Sales Taxes	136.5
Corporate Profit Taxes	8.7
Personal Income Taxes	33.1
Other	97.3
TOTAL	434.0
1999	
Customs Duties	137.9
Excise Duties	91.6
Sales Taxes	125.2
Corporate Profit Taxes	9.9
Personal Income Taxes	45.1
Other	111.5
TOTAL	521.2

Source : CAFAO

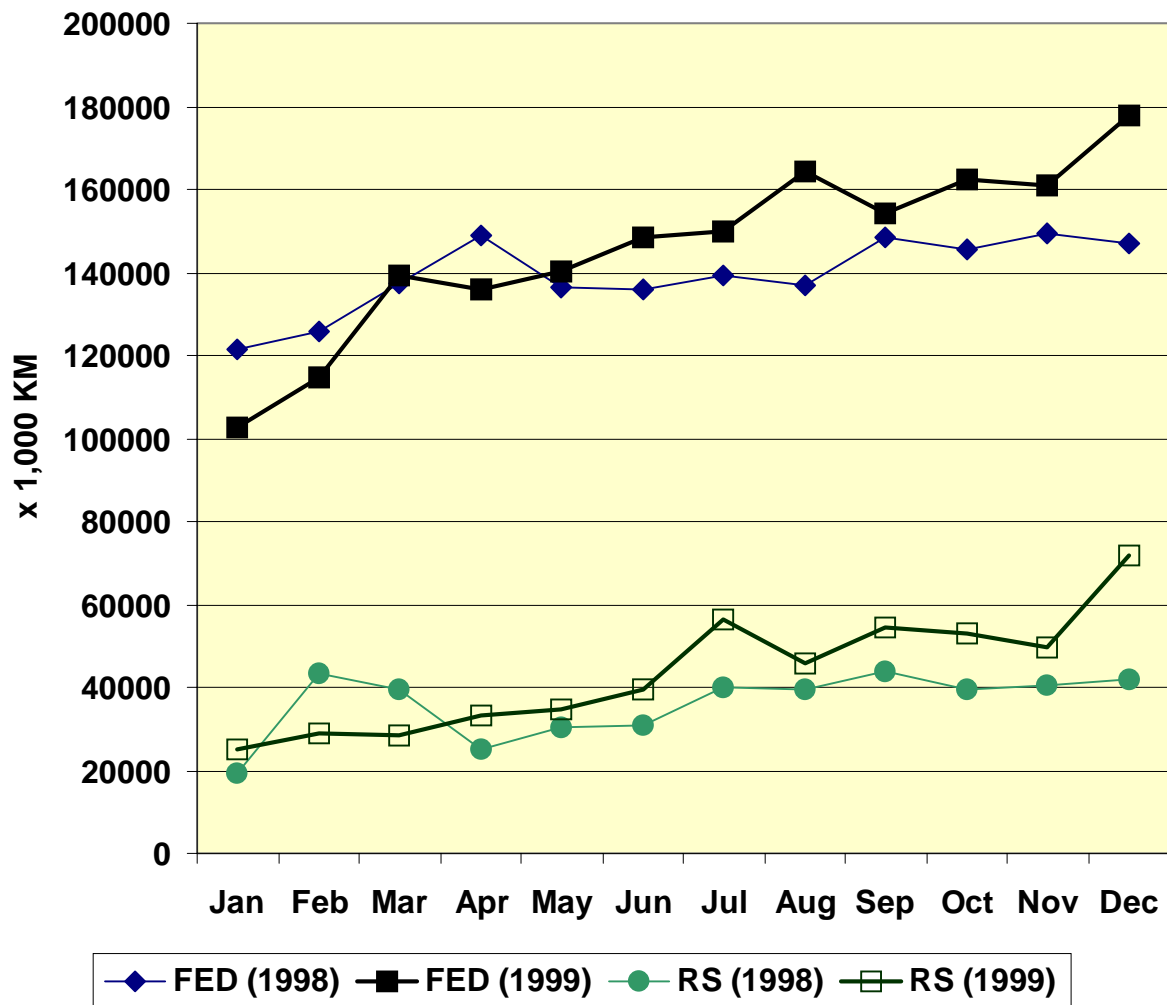
Table 14 : Total Public Revenue (RS)

(million KM)

Description	Jan-September 1999
Public Revenue (central government)	229
Social Insurance Funds	103
Other	5
TOTAL	337
<i>reminder : tax revenue (Source : CAFAO)</i>	346.5

Source : CBBH

TAX REVENUE (FED) & PUBLIC REVENUE (RS)



VII. Monetary and Financial Sectors

A. BANKING

Since the establishment of the Central Bank of BiH²⁵ in August 1997, substantial progress has been achieved in promoting the use of the KM. The currency board has definitely contributed to relative price stability in the segment of the Federation where the KM is widely used. One could claim that the currency board arrangement restricts commercial banking development. However, the technical insolvency, under-capitalization and inadequate commercial or retail banking are more serious constraints, as is the existence of the payment bureaux.

Box : the banking sector in BiH

The BiH financial sector is weak. According to data from the Bank Privatization Units (Ministries of Finance), of the 71 banks (53 in Federation and 18 in RS) that existed end of 1998, 18 banks (8 in Federation and 11 in RS) are majority-owned by the public sector.

Mid-1996, total banking system assets were estimated at DM 8.6 billion. But with a large percentage of assets non-performing, banking system assets were more likely to have been about DM 1.1 billion. Capital of the banking system was about half a billion DM but write-offs (at least DM 3.6 billion), heavily concentrated in a few State-Owned banks, exceeded capital.

Of these 71 banks less than 10 were financially acceptable, the other banks being mediocre, financially poor or technically insolvent. Banks charge high lending interest rates (averaging 23 % and up to 40 %) and operate with large spreads between lending and deposit interest rates (from 7 to 30 %).

Table : interest rate spread

<i><u>BiH</u></i>	<i><u>lower-income</u> <u>countries</u></i>	<i><u>lower-middle income</u> <u>countries</u></i>	<i><u>higher-middle income</u> <u>countries</u></i>
7-30 %	10.5 % (median)	9.5 % (median)	6.1 % (median)

²⁵ Under the June 1997 Law on the Central Bank of Bosnia and Herzegovina, the Central Bank will operate as a currency board for the first six years of its existence, issuing the new domestic currency (KM) at the fixed exchange rate of 1 KM – 1 DM. During this six-year period the CBBiH is restricted from engaging in the extension of credit through the creation of money (i.e. there is no room for an independent monetary policy as the monetary authority cannot act as a lender of last resort and loses the interest rate as a policy tool; interest rates are market determined and the monetary authorities cannot influence interest rates directly). The CBBiH may impose reserve requirements against KM deposits at commercial banks. Broad money supply expands in connection with foreign financing and private inflows.

State-Owned Banks have little access to deposits or other funding sources as most of their assets are non-performing loans and most of their liabilities are frozen currency deposits and loans from foreign lenders that cannot be repaid.

According to Entity bank privatization laws, all state-owned banks in BiH will be privatized or liquidated, if insolvent, by 2000. In order to avoid liquidation and/or formal privatization, a wave of bank mergers and re-capitalization is observed (in the Federation, this is due, in part, to the provisions of the commercial banking laws that doubled the size of net capital from KM2.5 million to KM5 million as of April 23, 1999). Restructuring of the financial sector in both Entities is anticipated to lead to a reduction in the number of banks from the initially 18 State-Owned and 53 private banks to about 15-20 stronger banks.

Banks have yet to overcome depositor skepticism caused by citizens' experiences with hyperinflation and the loss of foreign exchange deposits as a result of the 1992-95 civil war, as well as to diversify their services and adopt a rational fee structure. Introduction of a deposit insurance agency and one or more foreign banks in each entity would enhance the public's confidence in the BiH banking sector.

Term lending is funded almost exclusively from donor credit lines, at attractive interest rates linked to London Interbank Offer Rate (LIBOR) e.g. USAID's Business Finance (BF) program. Interest rates on short term credits are high, though they have come down since December 1997, and are subject to large variances. The high rate on short-term loans reflects the scarcity of capital and the risk of default.

The level of monetization is low in BiH. According to data released by the Central Bank, Money (M1) totaled KM310 million at the end of 1998, or 6.2% of nominal GDP²⁶. At the end of 1999, this ratio could have increased to 7.3%. Currency outside banks (KM253 million on 30.09.99) is likely to be underestimated.

On the other hand, the Broad Money supply (M2), which includes quasi-money, was equivalent to 22.4% of GDP (December 1998).²⁷ At the end of 1999, this ratio could have increased to 23.3%. This low ratio is an indication of restricted supply of and/or demand for financial savings instruments of the present banking sector. Most deposits at commercial banks are held by registered businesses; households hold less than **one third** of demand and time deposits.

An increasing share of credit in GDP indicates intensification and widening scope of banking activity. Moreover, when credit to the corporate sector increases faster than the narrow components of money supply (M0 and M1), this suggests an increase in the value of the money multipliers and thus a deepening of financial intermediation in the country:

²⁶ Equivalent percentages are 9.8% in Croatia, 7.9% in Slovenia, 22.7% in the Czech Republic, 13.9% in Poland, 16% in Hungary, 17.9% in Estonia, 13.1% in the USA.

²⁷ Equivalent figures (1998) are 39.5% in Croatia, 47.3% in Slovenia, 67.6% in Czech Republic, 43% in Poland, 33% in Hungary, 25.4% in Estonia and 52% in the USA (Sources : (a) "Economic Survey of Europe", Economic Commission for Europe, 1999, No.1, (b) IMF)

- At the end of 1998, the ratio of *Commercial Banks Claims on the Economy to M1* was 9.06 (virtually unchanged since Dec-97). Mid-1999, the ratio had fallen to 5.1, indicating an *apparent* reduction in financial intermediation.
- Furthermore, in 1998, the ratio of *Commercial Banks Claims on the Economy to GDP* was 40.7%.²⁸ This compares to 48.5% in the USA, 40.4% in Croatia, 63.6% in the Czech Republic and only 28.4% in Slovenia.

How does the financial system in BiH compare with other groups of countries?

Box : financial system parameters

Liquid Liabilities to GDP (LL) equals the ratio of liquid liabilities of bank and non-bank financial intermediaries to GDP. It is general indicator of the size of financial intermediaries relative to the size of the economy.

Bank Assets/GDP (BA) equals the ratio of the total domestic assets of deposit money banks by GDP. It is a measure of the overall size of the banking sector.

Claims of Deposit Money Banks on Private Sector/GDP (CP) equals deposit money bank credits to the private sector as a share of GDP. It is an indicator of bank activity in the private sector.

	<u>BiH</u>	<u>lower-income</u> <u>countries</u>	<u>lower middle-income</u> <u>countries</u>	<u>higher middle-income</u> <u>countries</u>
LL	0.35	0.37	0.43	0.38
BA	0.45	0.27	0.32	0.32
CP	0.22	0.21	0.21	0.24

How does employment in the BiH financial sector (1998; Federation and RS) compare to other countries ?

In the Federation, employment was 690 per 100,000 of population (1998). In the RS, employment is 277 per 100,000 of population. Equivalent data for other countries were: Bulgaria (624), Croatia (854), Czech Republic (3136), Hungary (1746), Poland (614). Slovenia (1678), Turkey (790), United Kingdom (4140), France (3211).

Sources : - *A New Database on Financial Development and Structure*, World Bank, January 1999
 - *Banking Reform in transition countries*, World Bank, June 1997

²⁸ This relatively high ratio may be an indication that banks' portfolios are burdened with substantial shares of substandard and non-performing loans. Indeed, a report issued by the Banking Agency of the Federation (November 1998) indicates that just over **half** of commercial banks' assets are risky (inducing potential losses). Banks thus tend to charge higher interest rates to their "good" clients in order to be able to compensate for the lost income. This results in higher spreads between lending and deposit rates. The high interest rates on short-term credits – up to 40% -- and the large spreads vis-à-vis savings deposit rates – 7 to 30% -- would confirm the hypothesis of bad assets on banks' balance sheets in BiH.

B. PAYMENTS SYSTEM

The payments bureaus (ZPP, ZAP, SPP) are a legacy of the socialist economic system. In addition to providing – rather inefficiently -- payments services, the payments bureaus carry out a series of functions not compatible with a *clearing-house* in a market economy.

The payment bureaus have a total staff of over 2,800. Three quarters of them are female. Up to 20% have a university degree.

Just how inefficient is the payments system in BiH? On the basis of ZPP and ZAP data for 1999, each citizen “initiates”, on average, 15 transactions per year. This volume is well below the number of transactions in high-income countries.

Table : payments transactions, per capita and per year

USA	264
France	253
Belgium	174
The Netherlands	170
Canada	164
Germany	156
UK	143
Sweden	104
Switzerland	98
Italy	41

Source : Bank for International Settlements (1997)

The costs of a payments system costs in advanced economies are under 3% percent GDP.²⁹ In the USA, about 45% of this cost are related to paper-based payments (as opposed to electronic payments). In the USA also, clearing house and settlement expenses account for 10% of the total costs for a paper-based payment and for about 20% in case of an electronic payment.³⁰ Thus, the total expenses of the clearing house and settlement function is not more than 0.3% of GDP. By comparison, and based on revenue data from ZPP, ZAP and SPP (1997), the Payment Bureaus operations are estimated to cost to the economy 1.43% of GDP in direct expenses (making

²⁹ Payment expenses are incurred by all parties to a payment transaction. This includes payers (individuals and businesses) who initiate payments and payees who receive them. For non-cash payments, it also includes the financial institutions acting as agents for payers and payees who process the payment information and actually transfer the funds. If more than one bank is involved, as when the payer and payee do not have the same payment agent, then inter-bank settlement of the payment is required.

³⁰ However, since the unit cost of an electronic payment is only 45 % of the unit cost of a paper-based payment, the clearing house and settlement expenses (in US cents) per transaction is grossly equivalent.

abstraction of the payer and payee bank costs).³¹ Thus, the Payment Bureaus are cost-inefficient, certainly considering the low volume of transactions (per capita).

An International Advisory Group comprising USAID, EU, OHR, WB and IMF monitors the elimination process of the PBs: transfer of statistical, treasury, accounting, tax administration functions to the Statistics Institutes and Ministry of Finance. It is anticipated that the clearing-house function will be transferred to an institution to be created by the commercial banks and the Central Bank (this process may take itself up to 19 calendar months). According to plan, the elimination should be completed by December 2000, at which time the PBs should be abolished. This will create a more enabling environment for commercial banking. The transformation is also expected to lower (payments) transaction costs.

Elimination of the payment bureaus is expected to create an unemployment problem among current staff of the organizations. The European Commission is prepared to fund an integrated project to mitigate the social impact of payments bureaus elimination.

Table 15 : Monetary and Financial Sector Survey

Million KM

End-of-period	Broad Money (M2)	Narrow Money (M1)	Commercial Banks Claims on the Economy (excl. Gov.)		
			BiH	Federation	RS
30.09.97	971	354			
31.12.97	1,178	252	2,306	1,764	538
31.03.98	1,166	235	2,603	1,845	757
30.06.98	1,140	202	2,576	1,852	723
30.09.98	1,321	247	2,624	1,848	776
31.12.98	1,547	310	2,808	1,906	901
31.01.99	1,544	302	2,837	1,917	920
28.02.99	1,492	318	2,757	1,954	803
31.03.99	1,510	332	2,712	1,874	838
30.04.99	1,551	349	2,724	1,891	833
31.05.99	1,565	349	2,729	1,883	846
30.06.99	1,608	378	2,748	1,880	868
31.07.99	1,665	435	2,711	1,832	879
31.08.99	1,742	433	2,723	1,835	888
30.09.99	1,726	542	2,736	1,833	903

Source : CBBH

³¹ Furthermore, a USAID-funded study (1999) reports cost additional estimates incurred by businesses (because of costs of excess labor dealing with paperwork) – at least 1.5% of GDP -- as well income foregone (interest income and economic growth) equivalent to another 2.3% of GDP.

Table 16 : Commercial Banks Claims on the Economy (excl. Gov.)

Million KM

	Federation			RS		
	31.12.98	30.6.99	30.9.99	31.12.98	30.6.99	30.9.99
Short-term	633.1	626.9	592.2	282.0	192.7	218.7
<i>public enterprises</i>	194.0	208.0	200.1	5.8	5.7	3.7
<i>private enterprises</i>	385.7	364.5	332.6	150.6	174.5	201.8
<i>others (incl. households)</i>	53.4	54.4	59.5	125.6	12.5	13.2
Long-term	1,272.7	1,251.7	1,241.0	619.3	675.2	684.2
<i>public enterprises</i>	897.0	864.8	867.1	3.1	3.4	3.4
<i>private enterprises</i>	170.7	172.7	187.8	612.8	668.5	677.4
<i>others (incl. households)</i>	205.0	214.1	186.2	3.4	3.3	3.4
TOTAL	1,905.8	1,878.6	1,833.2	901.3	867.9	902.9

Source : CBBH

Table 17 : Lending Interest Rates (Annual %)

Bank	Short-Term Credits	
	Minimum	Maximum
BH banka Sarajevo	19.56	28.46
Gospodarska banka Sarajevo	18	30
Komerc banka Tesanj	30	36
Komercijalna banka Tuzla	8.17	40.27
Market banka Sarajevo	12	36
Postanska banka Sarajevo	19	26
Tuzlanska banka Tuzla	32.32	36.58
Universal banka Sarajevo	19	37.67
Union banka Sarajevo	12.68	23.43
UPI banka Sarajevo	14.1	26.8
Central Profit banka	15	20
Gospodarska banka Mostar	8.4	18
Hrvatska postanska banka Herceg-Bosna	9	24
Agroprom banka	12	18
Kristal banka	14	14

Source : CBBH

VII. Privatization

Box : losses of State-Owned Enterprises

Private businesses contribute more to profits generation than do Public Enterprises.

Federation

- In 1998, Public Enterprises counted for 73.6% of all accounting losses incurred (mixed enterprises counted for another 14.5% of losses) whilst private companies contributed for 58.4% of all profits generated.
- In the same year, Public Enterprises generated KM3.6 billion of Sales revenue and incurred 540 million of accounting losses (corresponding to over 10% of GDP).
- Almost 1 company in 2 slated for Large-Scale Privatization is suffering (accounting) losses; 55% of public enterprises in industry and mining are recording losses.
- Public Enterprises are characterized by low productivity of Assets (e.g. in the Federation industry, KM1 of Assets, at Book Value, generates only KM0.1 of Sales as against 1-3 in market economies).

Republika Srpska

- Net losses recorded in 1998 (all enterprises) were KM483 million, which is equivalent to 26.3% of output. Ninety percent of these losses were incurred in Industry and Mining.

In spite of the huge losses recorded by State-Owned Enterprises, the process of enterprise restructuring has yet to start. Presently, enterprise management does not possess the autonomy required to conduct the restructuring task.

A. FEDERATION

According to an update of October 15, there are 1,610 enterprises up for privatization in the **Federation** (of these 101 enterprises are not operating and in 81 enterprises the State has only a minority equity share). The number of enterprises going to the Small-Scale Privatization program is 387 (the SSP concerns trading, catering, services enterprises, road transport, non-core and unused assets of large enterprises, municipal business premises, and enterprises with fewer than 50 employees and less than DM500,000 in totals assets. The number of enterprises going to the Large-Scale Privatization program is 1,068 (enterprises are required to develop their own privatization plan and prepare an opening balance sheet; auctions, tenders, direct sales agreements and public offering of shares are the principal methods for selling the enterprises. For SSP, the Law requires at least 35% cash payment and the balance to be made up in cash or (citizens) claims. Any combination of cash and claims can be used to purchase assets sold under mass privatization.

As of October 15, 1999, 356 enterprises had submitted proposals for sale of assets/parts in SSP. 480 enterprises had submitted an Opening Balance Sheet (the number of OBS returned for

correction is 262). 332 enterprises had submitted a Privatization Plan (the number of PPs returned for correction is 109). Enterprise preparation therefore continues to lag far behind scheduled legal deadlines.

As of December 6, 1999 the ten Cantonal Privatization Agencies had announced 551 auctions/tenders to sell off 1695 objects. 267 auctions/tenders were effectively held selling 419 objects (leaving 790 objects unsold).

The Privatization Agency has created citizen claim accounts of different types :

- General claim (provided to all citizens based on number of working years)
- Frozen Foreign Currency claims
- Military Back Pay (to members of the armies of BH and police during the war)
- Pension Arrears
- Restitution (claims to compensate former owners who were deprived of property by forceful acts of the State; however, a Restitution Law has still to pass Parliament)

As of December 9, 1999, over 2.1 million citizen's accounts had been opened for a value of KM15.4 billion of points. The number claims extinguished was KM248 million of points. On the supply side the (book) value of assets to be sold is estimated at KM32 billion.

Citizens can invest privatization claims in Privatization Investment Funds; these institutions will be intermediaries in administering privatization transactions between citizens and enterprises slated for privatization.

Citizens occupying apartments with existing tenancy rights – they are an estimated 70,000 in this category -- have the right and opportunity to purchase his/her apartment. Buyers may be eligible for discounts based on accumulated working experience, military and police service, wartime working duty, war victims and for cash payment. The owners of apartments – enterprises, municipalities' etc – will themselves execute sales.

B. REPUBLIKA SRPSKA

In the **Republika Srpska**, the privatization process is somewhat different. Citizens are eligible for a voucher (a general claim equal for all citizens, specific claims related for veterans and families of killed soldiers or missing in action). Registration of citizens starts on January 3, 2000, for 45 days; the Ministry of Interior database has 1.4 million records and another 780,000 records of refugees and Displaced Persons exist. The Directorate for Privatization expects at least 94% of the estimated population to register. Holders of lost foreign currency savings are provided an opportunity to convert all or part of their savings into coupons, which are treated as cash equivalents at cash sales. In a later stage, holders will be given the opportunity to convert savings into certificates for apartments and purchase of state-owned business premises. Restitution is not provided based on the current privatization legislation but a separate Restitution Law has been drafted.

According to the Directorate for Privatization (DFP), 1,541 enterprises entered the privatization process, and for 240 enterprises DFP still need to confirm the data.

Small-scale enterprises (firms with less than KM 300,000 in capital) will be privatized through a combination of cash and coupon sales. Assets of large-scale enterprises will be sold as follows: at least 55 percent for vouchers, 15 percent for restitution and pension funds, and the remaining 30 percent to strategic investors for cash or investment tenders or through remaining vouchers, cash, or coupons. Strategic enterprises will be privatized (partly by Public Offering) as individual projects approved by the Government.

The Government set a deadline for enterprise preparation (500 enterprises). This involves ownership transformation, Opening Balance Sheet preparation, Privatization Plan preparation.

A Pilot Auction Program was completed in October (1999). A total of 22 enterprises were offered in the pilot sales programs (at 5 auction centers) of which 9 were sold successfully. Approximately 25% of the proceeds were collected in cash and 75% were collected in the form of frozen foreign currency coupons. As for the future, the capacity of DFP is to offer some 100 enterprises/month as soon as their privatization programs get approved.

C. TRADING OF CLAIMS

Financial assets that are being traded in BiH at present are claims that can be used to bid on assets in the Federation privatization process. Such claims that are known to be traded include soldiers' paybooks that were acquired during the war by former soldiers who have not yet been paid, and, frozen foreign currency accounts. Sellers of soldiers' paybooks or frozen currency accounts place advertisements in newspapers, in particular in the commercial weekly "Oglasi" published in Sarajevo (soldiers paybooks account for the vast majority of these ads). The ads usually quote the face value of the paycheck and often quote an asking price.

The average asking price for paybooks used to hover between 20 and 40 %, until end of September 1999, averaging about 30%. However, from July on the average asking price started to slide reaching 12% in December 1999. The decline continued in February 2000 (the asking price falling to 9.7% of face value, on February 11). With the actual privatization process having started, the number of offers remained high until end of November, dropping sharply thereafter until February 2000.

Regional Statistics

The statistical institutes in BiH produce very few regional statistics.

Nevertheless, the Federation institute publishes Canton-level data on demography, Value Added, industrial production, wages, land use, construction, foreign trade, education. Tax revenue data by Canton and Municipality are also available.

The RS institute publishes data on construction and education, by Municipality. Tax revenue data by Municipality are also available.

UNHCR has published population data at the municipal level.

The tables hereafter compile the most relevant data in view of better understanding the geographic concentration of economic activity.

On a Value Added per capita basis, the Sarajevo Canton is the powerhouse in the Federation, followed by Canton 7 and Canton 8. In absolute figures, the Tuzla Canton ranks second in terms of Value Added and population. The Tuzla municipality also ranks high in terms of public revenue generation.

Table : regional statistics for the Federation (Canton level)

Federation (Cantons)	Canton and Municipal Revenue <i>Million KM</i> 1997	population 1997	monthly net wages <i>KM</i> Nov-99	Value Added <i>Million KM</i> 1998
Una-Sana	117.2	267,581	406	428
Posavina	42.6	47,933	235	79
Tuzla	271.3	610,572	361	918
Zenica-Doboj	170.7	450,924	332	646
Bosnia-Podrinje (Gorazde)	29.7	40,119	343	53
Central Bosnia	97.2	257,613	326	405
Herzegovina-Neretva	126.4	233,262	418	694
West Herzegovina (Zapod.-Herce.)	58.8	90,979	379	256
Sarajevo	523.5	354,470	482	1,796
Herzeg-Bosnia (Livanjski)	22.7	90,079	326	133

Table : Public Revenue (excl. customs taxes & excise) in major municipalities of the Federation

Federation	% of total Revenue (1998)	% of total population
Canton-9 : Sarajevo	36.6	14.4
Tuzla (Canton-3)	10	6.5
Zenica (Canton-4)	4.6	6.1
Bihac (Canton-1)	3.8	2.1
Mostar (Canton-7)	3.4	4.3
Citluk (Canton-7)	2.1	0.7
Zivinice (Canton-3)	1.8	2.8
Travnik (Canton-6)	1.7	2.3
Siroki Brijeg (Canton-8)	1.7	1.2
Cazin (Canton-1)	1.6	2.2

In the Republic Srpska, public revenue generation is heavily skewed towards Banja Luka municipality, accounting for almost 58% of public revenue. Interesting also, all the RS municipalities located South of Bijeljina account for only 28% of RS population and for 13% of public revenue.

Table : Public Revenue in RS municipalities

Municipalities	Public Revenue million KM 1998	population 1997	Municipalities	Public Revenue million KM 1998	population 1997
Banja Luka	188.1	220,407	Visegrad	1.2	15,585
Bijeljina	23.1	99,752	Rogatica	1.1	12,383
Doboj	8.4	82,969	Bratunac	1.1	25,533
Brcko	7.1	48,741	Knezevo	1.0	14,190
Gradiska	6.3	57,750	Kotor Varos	1.0	19,888
Zvornik	6.3	55,564	Vlasenica	0.9	14,722
Prijedor	5.9	88,811	Sipovo	0.9	14,763
Pale	5.8	20,792	Milici	0.9	11,617
Laktasi	5.6	40,599	Nevesinnje	0.9	18,868
Prnjavor	5.4	46,475	Han Pijesak	0.6	2,982
Lopare	4.4	19,667	Srebrenica/Skelani	0.6	10,894
Modrica	4.4	29,503	Srpski Orasje	0.6	149
Trebinje	4.1	37,484	Sekovici	0.5	9,629
Srpski Drvar	3.4	n.a.	Ribnik	0.5	9,632
Derventa	3.1	37,570	Srpska Kostajnica	0.5	12,099
Srpski Brod	2.9	22,400	Petrovo	0.5	18,393
Novi Grad	2.4	32,166	Cajnice	0.4	9,449
Samac	2.4	22,763	Kalinovik	0.3	6,109
Kozarska Dubica	2.3	24,946	Ljubinja	0.3	4,883
Srbinje	2.1	20,300	Rudo	0.3	9,137
Sokolac	2.0	10,392	Sanski Most	0.2	4,483
Srbac	1.9	14,520	Srpski Gorazde	0.2	7,232
Srpska Kupres+Mostar	1.8	marginal	Stari Grad	0.1	1,514
Ugljevik	1.6	21,778	Trnovo	0.1	1,036
Mrkonjic Grad	1.6	23,024	Berkovci	0.09	3,500
Pelagicevo	1.6	5,591	Kalesija/Osmaci	0.07	8,737
Novo Sarajevo	1.5	13,322	Vukosavlje	0.06	3,163
Gacko	1.5	17,320	Krupa na Uni	0.05	2,957
Ilidza	1.4	18,954	Jezero	0.03	marginal
Bileca	1.3	14,786	Teslic	0.02	46,110
Celinac	1.2	17,583	Petrovac	0.00	marginal

Profile of the industrial sector in the Republic Srpska ³²

1. INTRODUCTION

In 1998, a new government and a new Prime Minister took office in the Republic Srpska; both were more in tune with the international donor community. Significant amounts of credits, loans and other types of assistance were granted to the RS throughout 1998, especially for the reconstruction of the infrastructure. In addition, several credit lines for the private sector were launched. All of this resulted in improved economic activity and living standards of the population.

In 1998, the trade between the two Entities in Bosnia and Herzegovina (BiH) resumed, followed with the resumption of foreign trade with former Yugoslav republics, especially Croatia and Slovenia. After a long period of isolation communication with the Western markets was re-established, mainly with the European Union. In the same year a new and stable BiH currency, the Konvertibilna Marka (KM), gained a considerable share of the RS money supply.

To summarize, in 1998 the business environment in the RS improved substantially, which resulted in growth of several economic indicators, namely industrial production, GDP and the average wage rates. Regardless of these positive trends economic activity is still at low level. Therefore, considering the great efforts made in 1998, the results are not yet satisfactory.

In 1999, the business environment worsened mainly due to the loss of the market in FR Yugoslavia (which can be attributed to a payments crisis, the NATO campaign and economic sanctions imposed on FRY). According to some estimates, 25% of GDP (in RS) is linked one way or another with Yugoslavia (exports of finished goods, imports of inputs). The loss of this market could not be replaced by the exports to the Federation of BiH (still a small market marked by low purchasing power of the population), Croatia (due to political issues which are limiting trade), nor Slovenia (possibly due inadequate quality of RS products). Moreover, prices on these markets are significantly higher than in Yugoslavia, as are the customs and transport costs. This could explain why, according to the Central Bank of BiH, the prices in the RS in the first 9 months of 1999 were 13% higher than in the same period last year whereas they remained more or less stable in the Federation of BiH. At the same time the exchange rate of the KM remained unchanged at parity with the German Mark (DM).

³² **Prof. Mladen Ivanic** (December 1999). The preparation of this report has been sponsored by *USAID-Macroeconomic Technical Assistance Project*

To gain an insight of the RS economy we first look at GDP performance over the last few years (**Table 1.1.**). Until 1995, GDP followed a decreasing trend due to the war and economic sanctions. Many production activities were re-started in 1996 and in the three-year period 1996-1998 annual GDP on average increased by more than 18%. Such high growth rates can be explained by the very low base from where the economy restarted, and not because of some spectacular economic boom. Otherwise said, genuine and sustainable economic development in the RS has yet to take place. Unfortunately, as a consequence of the political events in neighboring Yugoslavia, we expect that GDP growth in 1999 will be very moderate at the best.

TABLE 1.1 : GDP in the RS in the period 1994 – 1998

	<i>Value in thousand US\$</i>	<i>Annual growth rate in %</i>
1994	794,227	
1995	636,909	-19.8
1996	759,521	19.2
1997	932,518	22.8
1998	1,049,579	12.6

Note: These are only rough estimates. Until 1997, official GDP statistics were compiled in Dinars. Starting from 1998 statistics are compiled in KM.

The structure of GDP in the RS compares very much with the structure in developing countries. **Table 1.2.** shows the sector breakdown of GDP for 1998.

TABLE 1.2. : sector breakdown of GDP (1998)

	<i>Value in thousand KM</i>	<i>Share in total GDP</i>
Industry	453,798	24.7
Agriculture	463,740	25.2
Forestry	74,384	4.0
Water production	2,062	0.1
Construction	77,826	4.2
Transport	113,890	6.2
Trade	175,762	9.6
Catering	48,334	2.6
Handicrafts	16,209	0.9
Housing and communal services	25,638	1.4
Financial and other services	108,333	5.9
Education, science, culture and information	86,782	4.7
Health and social protection	74,106	4.0
Social and political organizations	115,900	6.3
Total	1,836,764	100.0

Source: Republic Institute for Statistics, Banja Luka

Agriculture and forestry generated almost 30% of the GDP in 1998. When adding to this figure the industrial branches that transform natural resources (electricity, coal and wood), one observes that these sectors of primary production account for about 40% of total GDP. The share of the remaining industrial branches is only about 18% of GDP. Trade accounts for less than 10%. By contrast, the share of tertiary activities such as financial services, education, health, political organizations and other related activities exceeds 20%.

The total employment level of the RS is about 230,000 workers. The sectoral breakdown of employment is shown in **Table 1.3.**³³ Industry and agriculture account for over 140,000 employees, or more than 60% of total employment in the RS. Since the two sectors generate 50% of the GDP, these figures point at a situation of excessive employment. Another sector causing concern is 'Public and social services' with 30,449 employees. If we add to this figure the employees in other sectors that are also dependent on the budget, we observe that 15-20% of the total employment level is paid out of the budget. This contributes to high public expenditures and constitutes a heavy burden on the economy as well as jeopardizing growth prospects.

³³ Mind that self-employed, other than in agriculture, are excluded from this figure.

Table 1.3. : Employment structure in the RS

	<i>1997</i>	<i>in %</i>	<i>1998</i>	<i>in %</i>	<i>98/97</i>
Industry & mining	63,862	30.3	75,179	32.9	17.7
Agriculture & fishing	5,965	2.8	6,039	2.6	1.2
Self-employed in agriculture (est.)	60,000	28.5	60,000	26.3	0.0
Forestry	5,486	2.6	5,931	2.6	8.1
Water production	321	0.2	387	0.2	20.6
Construction	9,449	4.5	10,758	4.7	13.9
Transportation & telecommunication	10,576	5.0	11,083	4.9	4.8
Trade	13,781	6.5	15,521	6.8	12.6
Catering & tourism	3,245	1.5	3,389	1.5	4.4
Handicrafts	1,411	0.7	1,551	0.7	9.9
Housing & communal services	3,907	1.9	4,068	1.8	4.1
Financial & other services	2,820	1.3	4,012	1.8	42.3
Public & social services	*30,000	14.2	30,449	13.3	1.5
Total	210,823	100.0	228,367	100.0	8.3

Source: Republic Institute for Statistics, Banja Luka

** ESTIMATE*

2. CAPACITY UTILIZATION

Low capacity utilization, high production costs and low export competitiveness are interrelated. The problem of low capacity utilization appeared in the former Yugoslavia, in the early 1970s. Unfortunately, the socialist economic policy makers did not seriously consider this issue and nor did they want to comprehend their real origins. The government made attempts to resolve these and other economic problems, by increasing investments, protecting domestic markets, subsidies. Liquidation and restructuring of the inefficient and noncompetitive enterprises was unthinkable in the ex-Yugoslavia. In the years before the breakdown of Yugoslavia, most of the enterprises needed restructuring and a large number of them should have been liquidated. Adjustment and restructuring programs were prepared by the World Bank and the International Monetary Fund, but the beginning of the war and the breakdown of the country prevented implementation.

The Republic of Srpska inherited this state of the economy with low capacity utilization which the war in BiH and the UN sanctions aggravated. There exist no reliable figures regarding the level of capacity utilization in 1996, when the international embargo against the RS was lifted. World Bank estimates suggest that, at the end of 1996, production in BiH was only 8-10% of the pre-war level. An estimate of capacity utilization derived from this figure would be 7-8%.

Table 2.1. shows capacity utilization in the RS (1997 and 1998) for the industry and mining sectors, broken down to all relevant sub-sectors. There exist several methods of calculating capacity utilization, none of which is generally accepted (results form two possible approaches are presented). Table 2.1. also shows the shares of each sector in total industrial output (1998).

In 1997, the level of capacity utilization in the RS ranged between 10.7% and 12.8%, which is unusually low. Some 20 years earlier, capacity utilization in the former Yugoslavia was recorded at the level of 40-45%. Therefore, capacity utilization in the RS, in 1997, amounted to one quarter of the level 20 years ago.

In 1998, capacity utilization doubled to 23-25%. This considerable improvement can be explained by the fact that economic reconstruction started only in 1996 once the sanctions were lifted. Nevertheless, capacity utilization in 1998 is still no higher than 50% of the level prior to 1989, which illustrates the depth of the crisis in the RS economy.

Table 2.1. Capacity utilization in the RS (percentage)

	Capacity utilization (1997)		Capacity utilization (1998)		Share in output (1998)
	Method A ³⁴	Method B ³⁵	Method A	Method B	
Industry and mining, total	12.8	10.7	25.2	22.7	100.0
Electricity production	58.8	56.7	62.1	59.9	28.5
Coal production	35.0	29.3	62.3	58.7	6.6
Oil derivatives	14.5	12.9	30.4	26.8	2.8
Ferrous metals metallurgy	8.2	6.5	25.1	19.8	0.4
Nonferrous metals extraction	8.8	8.3	5.7	5.3	0.6
Nonferrous metals production	20.3	5.9	26.4	7.6	0.9
Nonferrous metals processing	0.0	0.0	1.2	1.2	0.2
Non-metal minerals extraction	13.1	10.1	18.2	14.4	0.9
Non-metal minerals processing	2.5	1.8	4.2	3.1	0.1
Metal processing	15.2	11.8	68.1	61.4	7.7
Machinery	11.7	9.9	12.7	11.4	1.8
Transport equipment	6.6	5.5	7.9	6.8	0.8
Electrical machinery industry	9.3	8.3	16.6	14.8	3.4
Basic chemicals	10.7	6.3	10.0	3.7	0.7
Chemical products processing	6.5	5.7	24.1	22.0	2.9
Concrete & sand production	15.5	12.6	29.3	24.3	0.7
Construction materials production	9.9	8.3	24.0	17.2	3.9
Processed lumber	27.9	23.0	29.3	24.4	5.4
Finished wood products	16.3	12.8	23.2	17.2	5.8
Paper industry	3.1	2.7	5.8	5.0	0.6
Textile industry	9.0	7.4	13.6	11.2	1.3
Clothing industry	8.6	7.2	1.8	1.7	7.7
Leather and fur industry	5.3	3.8	9.3	6.5	0.3
Leather shoes and products	23.0	17.8	19.7	13.0	2.1
Cotton processing	1.7	1.6	3.8	3.4	0.1
Food industry	4.8	4.0	12.2	9.1	8.8
Beverages production	34.4	31.0	49.0	39.5	2.6
Cattle food industry	9.7	8.7	19.6	18.6	0.4
Tobacco industry	49.2	40.4	49.2	42.2	1.3
Graphics industry	8.6	7.6	14.9	13.1	0.5
Recycling	27.9	26.3	22.0	21.0	0.2

Source: Republic Institute for Statistics, Banja Luka

³⁴ Measured assuming normal run-time hours of equipment.

³⁵ Measured assuming technologically feasible capacity of equipment.

The economic and political position of the RS economy has changed significantly since 1990. Before, BiH -- *and thus also the RS* -- was part of a larger European country, one of the most developed in Central and Eastern Europe. The FR Yugoslavia followed a socialist development strategy. A main principle of this strategy was the extreme diversification of the industrial production structure. The objective of such strategy was to meet the domestic needs. Exports occurred only when a surplus existed of domestic supply over domestic demand.

Presently the RS, as a part of BiH, is a small and lower-income country. The RS cannot sustain the same industrial development strategy as in the former Yugoslavia. Therefore, the diversified industrial structure inherited from the past is no longer viable. The industrial structure will have to undergo a fundamental transformation as an integral part of the ongoing reconstruction and restructuring of the entire RS economy.

The future industrial development strategy of the RS will have to be based on export expansion, an important principle neglected so far. Priority to development will go to those sectors, sub-sectors, and enterprises that have the ability to compete on the international and domestic markets. Accordingly, the allocation of funds for the restructuring of the industry and mining sectors will have to be guided by this criterion.

In the case of most RS enterprises, competitiveness is still primarily determined by production costs, out of which capital costs constitute a significant portion. RS labor costs are low due to the low level of salaries (in 1998, the average monthly net wage in was 133 KM, and the gross wage amounted to 222 KM), even though excessive employment and low labor productivity tend to reduce this unit labor cost advantage.

With production recovering, excessive employment will be progressively absorbed and both labor and capital productivity will increase ³⁶. Provided that the wage rate level remains competitive and provided that the growth rate of wages does not exceed labor productivity growth, then unit production costs will tend to decline and the competitiveness of enterprises will improve.

Enterprise restructuring efforts have to be guided by such considerations. There is no rationale for spending limited capital resources in an attempt to restructure enterprises that stand little chance to compete in the market in the short term (due to a large unit production costs).

Identifying the sectors and enterprises standing a stronger chance of restructuring requires a case-by-case analysis. Nevertheless, in the review hereafter we concentrate on the sectors with above-average capacity utilization levels (1997 and 1998). There are six sectors with capacity utilization approximately twice the industry and mining sector average. Presumably they have good restructuring and recovery potential.

³⁶ Unit capital costs decrease with increasing capacity utilization level.

- ***Electricity production*** - Capacity utilization is 62-65% in 1998. The existence of a captive domestic market explains this high level of capacity utilization : indeed, 75% of electricity is consumed by households. In this sector, capacities are relatively new with all production facilities utilized in 1998 (3 large hydro-power plants and 2 thermal-power plants). The capacity utilization level will also remain high in the future. Part of the output is exported to Croatia and FR Yugoslavia but in still insignificant volumes to make a real impact on the foreign trade balance of the RS. A key problem of electricity production in the RS – one that remains to be resolved -- is the low price of electricity for residential users. This results in severe financial losses (see the section : Financial Performance).
- ***Coal production*** - This sector supplies coal to the thermal-power plants, which explains the high level of capacity utilization. Households consume only small volumes of coal. Capacity utilization is 62.3% (method A) in 1998, up from 35% in 1997. The future of this sector is linked to that of the electricity production sector, but it depends also on the quality and volume of coal deposits.
- ***Processed lumber*** - This sector achieved capacity utilization above the industry average (between 24.4-29.3% in 1998) thanks to cheap and easily available raw material, wood. The sector consists of mostly small private sawmills whose owners are readily able to find markets (mostly in FR Yugoslavia).
- ***Leather shoes and other small leather products*** – The high level of capacity utilization results from the fact that the industry is producing for foreign companies as well as for humanitarian organizations. However, the sector's production represents only 2.1% of total industrial output. Wholesale prices are low. This sector needs restructuring. Prior to the war the industry produced mainly for the Eastern European markets, but this option is no longer so straightforward. Illustrating perhaps this trend is the decrease in capacity utilization (from 17.8-23% in 1997 down to 13-19.7% in 1998).
- ***Beverages*** - This sector is not very large with one brewery and several beverage producers accounting for only 2.6% of the total industrial output (1998). Capacity utilization is around 40-50% (1998). Generally, such a sector offers solid prospects.
- ***Tobacco industry*** - This sector consists of one producer that is able to sell its products on the local market (a large portion of the population has low standards of living). This sector is exposed to strong competition from the foreign products that are not subject to high import customs, duties and excises (indeed, smuggled cigarettes are widely available). This producer should have good prospects following privatization.

Following these six sectors, there is another group of industries with capacity utilization equal or slightly above the industry and mining average. Enterprises in these sectors are also potentially viable. However, again, a case-by-case analysis should be carried out in order to identify opportunities for restructuring investments or the necessity of downsizing or even liquidation.

- ***Oil and oil derivatives industry*** – Capacities are relatively modern. Standardized products are in demand on both domestic and neighboring countries' markets. Provided that feed supplies are secured, this industry has its niche in the RS economy, and its restructuring should not be too complex. In 1998, capacity utilization increased significantly (26.8-30.4%), following repair of equipment damaged during the war, in particular at the **Srpski Brod** refinery. This trend is likely to continue in 1999. The sector has good financial prospects considering the destruction of the refineries in Serbia, during the Kosovo crisis. A number of investors are interested in the privatization of the two refineries (indeed, besides Srpski Brod, there exists also a motor oil refinery in **Modrica**).
- ***Nonferrous metals industry*** - This industry consists of three sub-sectors. However, *de facto*, the restructuring problem boils down to one large and modern enterprise, **Birac** (Zvornik). Analyses going back to the late 1980s showed that this sector has a good economic perspective due to its export orientation. Research is needed to verify whether new investments will improve the competitiveness and promote exports. In 1998, production at Birac recovered significantly, in spite of many problems. Considering that the USSR and Eastern block used to be its main markets, a market review is necessary.
- ***Non-metal minerals industry*** – This sector consists of two sub-sectors accounting for just one percent of total industrial output (1998). Products are primarily sold in the domestic market. Therefore, it remains to be seen whether there is any justification in investing in their restructuring and development.
- ***Metal processing and machinery industry*** - The two sub-sectors account for 9.5% of total industrial output. Capacity utilization stood at around the industry and mining average (10-15%) in 1997. However, in 1998, capacity utilization in the metal processing sector jumped to above 60%. Bearing in mind that the metal processing industry received particular attention in the former Yugoslavia (supply exceeding by far demand), the economic perspective of the various production lines has now to be analyzed. Furthermore, considering that the metal industries are also relatively developed in the Federation of BiH, the viability and development prospects of this sector have to be looked at from an obviously larger geographic perspective and to be correlated between the Entities. Again, this sector used to sell on the Eastern European markets where little international competition existed. A major enterprise is **Jelsingrad** (Banja Luka). There exists no significant interest on the side of the foreign investors; without foreign investment it is difficult to expect major development of this sector. A definite strength of the metal processing industry is its well-trained labor force.
- ***Electrical machinery industry*** – Case-by-case analysis is required to determine the economic potential of the existing production lines. In the former Yugoslavia this industry was considered as well developed from the economic and technological perspective, but few investments were undertaken lately for its innovation and modernization. Globally, technology in the electrical industry is progressing very rapidly. Restructuring of this industry is likely to be very selective rather than wholesale. Another complication is that several major enterprises in this sector produced military equipment (e.g. **Rudi Cajavec**, Banja Luka), but after the break-up of Yugoslavia the market for such products ceased to exist. Some capacities will definitely have to be shut down.

- ***Chemical industry*** – This industry is very diversified and will require considerable restructuring. Good results were accomplished in 1998. The level of capacity utilization improved dramatically : capacity utilization of chemical products processing increased from 6.5% in 1997 to 24.1% in 1998 (method-A). Market competition is generally based on price. Analysis will show which sub-sectors and enterprises are attractive for further investments. Key problem is the outdated technology that was not brought to international environmental standards and is thus dangerous to the environment. The local market cannot absorb more than 10% of the output while exports are very difficult because of the previously mentioned environmental standards. The chemical industry is important from a social aspect as two enterprises, **Incel** (Banja Luka) and **Celpak** (Prijeedor) directly employ 5,000 workers.
- ***Concrete and sand production*** - This industry is mainly oriented towards small local markets. Considering its character, concrete and sand production industry should be privatized as soon as possible with the expectation that the new owners will be responsible for restructuring. Local demand for the products exists and we expect that prospective investors will not be too difficult to find, considering that capacity utilization improved dramatically between 1997 and 1998.
- ***Construction materials*** – Considering the relatively high transportation costs for bulky materials, this sector will always have an economic justification. Foreign trade generally plays only a minor role. The sector did not undergo any positive restructuring after the war. Even so, capacity utilization tripled in 1998 compared to 1997. Considering that the government has limited capital resources for restructuring investments – and nor should government be involved in such sectors – we anticipate that restructuring will occur post privatization.
- ***Finished wood products*** - This industry has a long tradition in BiH (and the RS) and is known for its export orientation. The financial-economic difficulties that the sector experiences today are mainly a consequence of the political developments in the early 1990s. Its restructuring is economically justified, but large additional investments will be needed for modernization. Another reason for putting this sector on the priority list for restructuring is the fact that it uses low-cost labor and raw materials. It is one of the sectors with long-term perspectives, provided that attention is paid to quality management, design and marketing.
- ***Clothing industry*** - In 1997, capacity utilization stood at 8%. Reportedly, in 1998, capacity utilization dropped to 2%. Still, this sector accounts for 7.7% of total industrial output (1998) and thus is an obvious candidate for restructuring. Furthermore, the sector employs a significant workforce and has longstanding tradition in production and exports. As usual, this sector is very diversified with large number of small producers in almost every municipality. Therefore, justification for restructuring arises also from the social dimension, since in the coming years unemployment will pose a serious threat to the RS economy.
- ***Food industry*** - The sector participates for 8.8 % in total industrial output. In 1997, capacity utilization at only 4%, increasing to around 12 % in 1998, which is still

unsatisfactory. The sector is very diversified. Restructuring is required but bearing in mind two factors :

Production costs: the sector suffers from high production costs due to inefficient diversification. Domestic consumers enjoyed low agricultural producers' prices. However, since over 90% of agriculture was privately owned, low farm-gate prices did not constitute an incentive to individual farmers. Farmers therefore diversified into non-agricultural activities. Restructuring of the food industry is now of crucial importance to the transformation of the RS economy. With increasing efficiency of the food industry, producers' prices can be raised without threatening the price competitiveness of finished products. This will make agricultural production more attractive.

Export orientation: the food industry will have to become more export oriented. This will enable costs reduction through economies of scale. Considering the geographical location of the RS, this objective is quite feasible.

We did not review the other sectors in further detail. This does not preclude that individual enterprises may rank high in the priorities for the restructuring process.

3. FINANCIAL PERFORMANCE

The enterprises of the Republic of Srpska (RS) are suffering large financial losses. This makes the RS quite different from the Western economies, where it is not common to have losses that exceed total profits at the macro-economic level.

Though the economy of the RS is an integral part of Bosnia and Herzegovina (BiH), the institutional foundations of BiH are not well defined, nor are they always operating adequately. Furthermore, the RS initiated transition and radical reforms only from 1996 on, when the UN sanctions were lifted. These factors can explain the existence of financial losses at the macro-economic level, but they cannot justify their size or persistence. It is not acceptable -- nor is it viable -- that an economy operates with enormous financial losses for several consecutive years.

³⁷

Table 3.1. (1997) and **Table 3.2.** (1998) show the sector breakdown of losses recorded in the RS economy. **Table 3.3.** offers some explanation of the financial performance of the whole economy.

According to data collected by the Development Bank, the RS business sector recorded, in 1997, net losses of 401 million Convertible Marks (KM), which was equivalent to 24.8% of GDP. In 1998, losses increased to 482.9 million KM, or approximately 26.3% of GDP. Furthermore, in the same year, so-called nonproductive activities (such as health and social protection, education, culture, science, etc.) also recorded net "losses" in the amount of 12.3 million KM, which accounted for an additional 6.7% of GDP. Therefore, in 1998, the economy recorded net losses of around 33% of the GDP. We do not have reliable figures for 1997 on the net losses of the social sector; we estimate them at 3.5-4% of the GDP, which would imply that the total net losses of the economy amounted to approximately 28.5% of GDP.³⁸

The size of net losses in the RS economy can also be measured against total gross wages. According to **Table 3.3.**, gross wages paid to employees (approximately 120,000) totaled 253.1 million KM. In 1998, gross wages totaled 368 million KM (for 138,000 employees). This means that net losses of the economy, in 1997, exceeded total gross wages by a margin of 58 %. In 1998, net losses exceeded total gross wages by a margin of 40%.^{39 40}

³⁷ Losses of this magnitude hide more than just inefficiency and unprofessional executive management of enterprises.

³⁸ It must be mentioned that these figures are only indicative, as methodological problems exist with the calculation of the financial results of the companies as well as of GDP. The fact that the RS economy records net losses of business activities at the macro-economic level, suggests the existence of large inter-company debts, liabilities to pension funds, tax administration and the like.

³⁹ Equally significant is that gross wages constitute less than 10 % of total business expenditures. Businesses would still make losses even if they did not pay any wages to employees, contributions to the social security system and taxes to the state.

⁴⁰ Table 3.3. shows large amounts under the categories 'other expenditures' and 'one-time expenditures'. The former comprises amortization, which is NOT a cash cost. Also, it is not clear to what extent the latter are current expenditures (rather than capital expenditures).

Table 3.1. Profits and losses in million KM, and wages in KM for 1997

	<i>Profits</i>	<i>Losses</i>	<i>Net losses</i>	<i>Net losses (% of total losses)</i>	<i>Net monthly wages</i>	<i>Employment (x 1,000)</i>	<i>Net losses as % of output</i>
Industry & mining	4.2	291.8	287.6	71.7	114	63.9	79.8
Agriculture	1.1	22.8	21.7	5.4	123	6.0	4.7
Forestry	0.2	1.4	1.2	0.3	116	5.5	1.9
Water production	0.0	0.2	0.2	0.0	101	0.3	12.5
Construction	1.0	4.0	3.0	0.8	130	9.4	4.1
Transport & telecom.	0.3	60.0	59.7	14.9	109	10.6	58.1
Trade	4.7	17.5	12.8	3.2	93	13.8	8.0
Tourism	0.1	4.1	4.0	1.0	80	3.2	8.5
Crafts	0.4	0.8	0.4	0.1	99	1.4	3.2
Housing & communal	0.1	7.0	6.9	1.7	291	3.9	37.1
Financial & other services	0.8	4.3	3.5	0.9	133	2.8	3.4
Economy, total	12.9	413.9	401.0	100.0	118	120.8	24.8

Table 3.2. Profits and losses in million KM, and wages in KM for 1998

	<i>Profits</i>	<i>Losses</i>	<i>Net losses</i>	<i>Net losses (% of total losses)</i>	<i>Net monthly wages</i>	<i>Employment (x 1,000)</i>	<i>Net losses as % of output</i>
Industry & mining	8.2	442.7	434.5	90.0	133	75.2	95.7
Agriculture	1.0	6.3	5.3	1.1	176	6.0	1.1
Forestry	0.5	1.0	0.5	0.1	163	5.9	0.0
Water production	0.0	0.0	0.0	0.0	163	0.4	0.0
Construction	1.5	2.4	0.9	0.2	124	10.8	1.2
Transport & telecom.	0.6	7.5	6.9	1.4	145	11.1	6.1
Trade	8.3	25.2	16.9	3.5	137	15.5	9.6
Tourism	0.3	2.8	2.5	0.5	107	3.4	5.2
Crafts	0.5	1.2	0.7	0.1	123	1.6	4.4
Housing & communal	0.1	9.1	9.0	1.9	447	4.1	35.2
Financial & other services	2.5	8.2	5.7	1.2	147	4.0	5.3
Economy, total	23.5	506.5	482.9	100.0	146	138.0	26.3

Note: Net losses of the social activities in 1998 amount to 12.3 million KM, which corresponds to 6.7% of GDP. Social activities are defined here as health and social insurance, education, culture, sport, science, government administration, and public and political organizations.

Source: Razvojna banka ad, Banja Luka

Table 3.3. Financial performance of the RS economy in million KM

	1997	1998	Share in % (1998)
TOTAL REVENUES	3,223.7	4,046.4	100.0
Business revenues	2,764.0	3,454.0	85.4
Domestic sales	2,457.7	3,107.1	76.8
Sales abroad	151.2	194.4	4.8
Subsidies and premiums	155.1	152.5	3.8
Financial revenues	267.3	419.9	10.4
Positive exchange rate effects	21.3	96.2	2.4
Positive revaluation effects	220.3	303.0	7.5
Other revenues	25.7	20.7	0.5
One time revenues	189.2	166.2	4.1
Capital gains	3.2	6.3	0.1
TOTAL EXPENDITURES	3,625.2	4,529.8	100.0
Business expenditures	3,143.4	3,652.8	80.7
Material & nonmaterial expenditures	1,415.7	1,893.6	41.8
Calculated gross wages	253.1	344.6	7.6
Other expenditures	1,474.6	1,414.6	31.3
Financial expenditures	209.6	626.0	13.8
Negative exchange rate effects	105.9	380.0	8.4
Negative revaluation effects	47.7	181.8	4.0
Other financial expenses	56.0	64.2	1.4
‘One time’-expenditures	269.5	250.2	5.5
Capital losses	2.7	0.8	0.0
PROFITS & LOSSES			
Profits	12.9	23.5	100.0
Industry & mining	4.1	8.2	34.9
Trade	4.7	8.3	35.3
Other activities	4.1	7.0	29.8
Losses	413.9	506.4	100.0
Industry & mining	291.8	442.7	87.4
Trade	17.5	25.2	5.0
Transport & telecommunication	60.0	7.5	1.5
Housing & communal services	7.0	9.2	1.8
Financial & other services	4.3	8.2	1.6
Other activities	33.3	13.6	2.7

Source: Razvojna banka ad, Banja Luka

The supporting tables show that a) over 80 % of total losses are recorded in industry and mining (1998), b) the average monthly salaries (by sector) are not correlated with the size of the losses. It is true that enterprises are burdened with excessive employment but this factor cannot solely explain the magnitude of losses. Rather, the better part of losses must be attributed to the low level of capacity utilization (and its impact on capital cost) as well as to the fall-out of deficiencies in the economic system defects of the economic system and economic policies.⁴¹

Between 1998 and 1997 – when GDP increased by 13.4 % or 217.6 million KM – total revenues increased by 25 % or 822.7 million KM. However, total expenditures also increased by 904 million KM, out of which 400 million KM represent an increase in financial expenditures (mostly related to (negative) exchange rate and ‘revaluation’ effects).

In the past, socially-owned enterprises did not pay realistic capital costs. In the future, companies will have to pay market lending rates if they want to borrow long term. The huge financial losses of companies and the high current account deficit recorded by BiH are not sustainable in the medium term. This situation will ultimately have to be resolved with a shock therapy (enterprise restructuring). Economic history also learns that countries operating under a regime of fixed exchange rates and running a huge current account deficit (not covered by long-term capital inflows such as foreign direct investments) ultimately are forced to depreciate their currency.

Looking at the sector breakdown of the net losses, one observes the following points:

1. The sector breakdown of net losses is highly related to the size of social and state ownership. This would confirm the assumption that the losses in the RS economy are largely due to the inherited deficiencies of the economic system – in particular in ownership rights and corporate governance -- and of economic policies. Following long periods of over-investment, today’s enterprises cannot accommodate for the capital expenditures obligations (maintenance and repairs, amortization) that result from the investments made in the past.
2. By far the largest share of the losses in the economy is concentrated in the industry and mining sector (71.7% of all losses in 1997 and 90% in 1998). This is understandable since these sectors are characterized by above-average capital intensity. Past investment decisions now imply capital expenditures that enterprises are not able to finance from current revenues.
3. The agriculture sector accounts for a similar share of the GDP than the industry and mining sector (about 25 %). However, the financial losses suffered in agriculture are only a fraction of the losses generated in industry and mining. This can be explained by the fact that the major part of the agriculture sector is in the private hands.
4. Losses are also significant in three other sectors: transportation and communication, trade, housing and communal services. Again, these sectors are either capital intensive or they are characterized by substantial social and state ownership.
5. The sector breakdown of losses varies significantly between 1997 and 1998. In 1998, the losses are more heavily concentrated in one sector, industry and mining. This trend demonstrates the urgency of an industrial restructuring program. However, enterprise restructuring will not be very successful without wholesale market-oriented reform.

⁴¹ Which affect demand and affect production costs.

4. BREAKDOWN BY OWNERSHIP

Prima facie, the ownership structure in the RS economy is easy to analyze since the total number of enterprises in each class of ownership is published by the Institute for Statistics.

Unfortunately it is difficult to carry the analysis much further since there exist no reliable figures on :

- the number and sector breakdown of employment in the private sector,
- the physical volume and value of production in the private sector.

Reliable statistical data on the financial performance of the private sector do not exist. Moreover, the total employment in the private sector is not known either. The number of employees in the non-agricultural activities in the private sector is estimated at 40,000. Since there are approximately 19,000 private companies in the RS, this means private companies employ on average 2.1 workers. Therefore, the private sector consists mainly of small firms, shops and family businesses. The private sector is still in the early stages of development and the RS economy is still faced with numerous economic problems that hamper its growth.

A second feature of the private sector is that it operates partly in the shadow or gray economy. Few of the large, private companies operate entirely legally, while the larger number keeps on trying to hide the actual volume of their operations. In other words they operate in the gray economy. There are two reasons for doing so :

- to minimize the amounts of taxes and contributions to be paid,
- because some of these firms' owners work directly in or are in some way connected with the government and socially-owned enterprises (which could look like a conflict of interests).

According to one estimate, the size of the gray economy in the RS in 1998 is estimated to be equivalent to 45% of official GDP. The sector breakdown of the shadow economy may roughly look as follows :

<i>Production in the private sector (shadow economy) in %</i>	<i>100</i>
Industry	18
Agriculture	9
Construction	12
Transport	14
Trade	22
Tourism	8
Crafts	5
Financial and other services	7
Other activities	5

Further research will be necessary to determine more precisely the size and sector breakdown of the private sector in the RS.

The ownership structure in the RS economy according to the number of entities registered is presented in **Table 4.1.** . The table calls for the following comments.

There exist a large number of legal entities unknown type of ownership (4,667). However, 99.4% of those belong to two groups of activities: social and political organizations, and education, science, culture and information.

In terms of numbers of enterprises registered in the RS, the private sector dominates with 19,173 businesses. State-owned and social-owned enterprises total 3,356, while enterprises with mixed ownership total 569. There are also 571 cooperative businesses registered in the RS. *Prima facie*, the RS economy may appear to be dominated by the private sector; 81 % of entities with known ownership (23,669) are actually in private hands. Privatization may thus not look so urgent. In reality, since the private sector counts mostly micro and small businesses, the economic power of the private sector is less than significant. Moreover, most of these private businesses belong to the trade sector (approximately 61.5%) and are self-employed entrepreneurs or family businesses.

Though state-owned and social-owned enterprises total ‘only’ 1,706 (if we exclude education, health etc organizations), almost all enterprises of some significance – whether measured in terms of output or employment -- in the RS belong to this ownership type. Therefore, it is still right to say that economic power in the RS is still concentrated with the State and with the social-owned enterprises. This puts the RS at a disadvantage since, according to market economy paradigm, the State is not a good owner and -- even less – good manager. Anyhow, the State does no longer possess sufficient capital resources to restructure such a large number of companies, which is the main prerequisite for solving the inherited problems in the economy.

Table 4.1. Ownership structure in the RS economy**(February
1999)**

	Total	<i>Social</i>	<i>State</i>	<i>Private</i>	<i>Cooperative</i>	<i>Mixed</i>	<i>Not known</i>
Industry & mining	2,868	102	366	2,251	16	134	0
Agriculture & fishing	829	36	76	555	157	5	0
Forestry	127	15	53	56	1	2	0
Water production	16	4	9	1	1	1	0
Construction	1,009	41	105	788	43	32	0
Transportation & telecommunication	1,063	27	49	944	16	27	0
Trade	12,323	159	163	11,787	38	176	0
Tourism	589	31	40	488	1	29	0
Crafts	640	13	24	516	64	23	0
Housing & communal services	129	17	70	32	0	2	8
Financial & other services	1,896	110	61	1,556	55	114	0
Education, science, culture & information	2,587	247	543	147	0	21	1,629
Health & social protection	255	29	23	43	0	2	23
Public and political organizations	4,004	230	578	9	179	1	3,007
Total	28,336	1,061	2,295	19,173	571	569	4,667

Source : Republic Institute for Statistics, Banja Luka

5. FOREIGN TRADE

All data on export and import performance are based on the transactions registered with the Banking Agency in the RS. According to the relevant law, companies have to register their export and import activities with that agency, in particular the transactions in foreign currencies. At the time of writing, data from the customs authorities were not available to the authors.

Data from the Agency do not include foreign trade with the FR Yugoslavia settled in Dinars or through barter arrangements. Thus, the data presented here do not give a full picture on the RS foreign trade. The analysis, nevertheless, gives insight of the trends in foreign trade with other countries.

It is worthwhile to remind some of the factors that the RS economy inherited from the economy of the socialist Yugoslavia.

The former Yugoslavia did not have a formal export strategy : simply, the surplus of supply over domestic demand was exported to other countries. Consequently, exports did not follow a rationale of export specialization. Exports of goods contributed to achieving the goal of securing foreign currencies necessary to import goods not produced domestically.

Another problem inherited is obviously the intersectoral dependence between the different (former) republics. After the break-up of the former Yugoslavia this created severe problems for the producers to sell on the markets of other former republics. In addition, the production inputs that originating from other republics were no longer available or their prices were much higher.

Until 1990, BiH exported approximately 25-30% of its industrial production, 30-35% of the production went to other republics of the former Yugoslavia, with the balance of 35% was sold domestically. As small countries depend heavily on exports, it is obvious that BiH and the RS need an export strategy. Until now the RS does not have such an export strategy or industrial development strategy. Exports occur occasionally and without a clear pattern. Except for **Birac**, Zvornik, an enterprise in the nonferrous metals industry, there is currently no other significant exporter. The RS economy requires a comprehensive restructuring process from which will also emerge a strategy of sustainable foreign trade development. This might be multi-phased. Barring non-tariff barriers, trade is usually easier to develop with close neighbors than with farther-away markets. Therefore, the competitive strategies of enterprises should focus first to compete on the easier bits of the domestic markets (BiH) and on the export markets of the former Yugoslav republics. Gradually, as BiH enterprises and products gain in competitiveness, they will be able to penetrate increasingly the European markets, in particular the European Union.

In the first six months of 1999, total RS exports amounted to 106.36 million US\$, while total imports amounted to 468.95 million of US\$. This means that the foreign trade deficit in the first half of 1999 was 362.59 million US\$. In the same period of 1997, exports were 63.23 million US\$, imports 231.13 million US\$, resulting in a trade deficit of 167.9 million US\$. Therefore, the foreign trade deficit increased by more than 100% in the first six months this year compared to the same period in 1998. Though this is not a sustainable trend, several factors explain the deficit such as imports linked to reconstruction aid, the war and tough economic sanctions that hit FR Yugoslavia which downsized the RS export market. The RS suddenly had to seek for imports of necessary goods from other countries that are more costly than Yugoslavia. It is expected that foreign trade data will continue to look bad for the second half of 1999 and that the trade deficit will rise above 400 million US\$, which represents an unacceptable high share of GDP.

Eventually, the RS will have to redirect its exports towards the markets of developed countries. However, in these markets the RS exporters will face competitors who offer products of higher quality at a similar or even lower price. It is necessary to determine those sectors, companies and products that can relatively quickly and at a low cost adjust to the tough rules and high standards of the international markets. The food processing industry is definitely one of those sectors that can relatively easily start exporting, especially to the countries of the former Yugoslavia. Looking in the longer term, electricity should be a source of export revenue, as the production of electricity accounts for 28.5% of the industrial output in 1998 (which should be more than the domestic demand). However, large investments are necessary for restructuring of this sector to enable efficient production and thus exports of a significant size. In the first three months of 1999, the prime exporter was **Birac**, Zvornik worth 31.45% of all exports in the RS as registered with the Agency for Banking.

Looking at the structure of the exports (registered with the Banking Agency) by destination (**Table 5.1.**) we see that 24% of total exports go to Italy, 15% to Cyprus, 14.6% to Slovenia, 10.7% to Germany. This structure is rational; however, we have to bear in mind that the FR Yugoslavia remains the major trading partner of the RS. Most of the transactions with Yugoslav companies are not registered as foreign trade and consequently the table would be look very different if they were included. The large amount of trade that take place with Cyprus is not surprising - due to relaxed tax regulations in this country there are many Cyprus-based private firms whose owners are citizens of the RS or Yugoslavia.

Table 5.1. Exports by destination (x 1,000 US\$)

<i>Country</i>	<i>January 1 - June 30, 1998</i>		<i>January 1 - June 30, 1999</i>		<i>% increase</i>
	Value	Percent share in total exports	Value	Percent share in total exports	
Italy	13,528	21.40	25,545	24.02	188.83
Cyprus	1,154	1.83	15,857	14.91	1,374.09
Slovenia	4,537	7.18	15,530	14.60	342.30
Germany	5,848	9.25	11,400	10.72	194.94
Austria	1,516	2.40	7,451	7.01	491.49
Croatia	330	0.52	5,459	5.13	1,654.24
Yugoslavia	-	-	3,815	3.59	-
Switzerland	1,719	2.72	3,473	3.27	202.04
Greece	3,307	5.23	2,390	2.25	72.27
USA	1,540	2.44	774	0.73	50.26
Romania	14,852	23.49	39	0.04	0.26
Federation of BiH	7,732	12.23	-	-	-
Other	7,163	11.33	14,623	13.75	204.15
Total	63,226	100.00	106,356	100.00	168.22

State-owned enterprises are still the major exporters with 51.3% of all exports realized in the first six months of 1999 (**Table 5.2.**). Nevertheless, private companies saw their share in exports rising from 37% of the total exports in the first six months of 1998, up to 40% of the total exports in the same period in 1999. In absolute figures, exports realized by the private firms in the first half of 1999 amounted to 24.59 million of US\$. This positive trend is still very slow, but it shows that the private sector can be a more efficient exporter than the State-owned enterprises. Similar to other Eastern European transition countries, we suspect that private trading firms in the RS are exporting goods actually produced by the State-owned companies. If so, there is a reason to believe that potential profits of State-owned enterprises are diverted to private companies.⁴²

**Table 5.2. Ownership structure of the exporters
January 1 - June 30, 1999**

<i>Ownership type</i>	<i>Exports (x 1,000 US\$)</i>	<i>%</i>
State-owned	54,607	51.34
Private	42,588	40.04
Mixed	5,146	4.84
Foreign capital	3,655	3.44
Other	360	0.34
Total	106,356	100.00

⁴² The scenario is that State-owned companies sell goods 'cheaply' or at below-market price to private companies controlled by parties and or executive management of the State-owned company.

In the first six months of 1999, total registered imports in the RS amounted to 468.95 US\$, which represents an increase of more than 100% compared to the same period in 1997 (**Table 5.3.**). The reason for this sharp increase in imports is mainly that importers effectuated a reorientation from Yugoslav suppliers to other European suppliers. During 1999 and the crisis in Yugoslavia, the RS began switching from non-registered to registered import transactions. In effect, this means that actual imports did not increase by as much. Another reason behind the increase in imports is that during 1998 living standard slowly began to rise, and consequently the purchasing power of the population strengthened, which resulted in increased demand for foreign-made consumer goods.

Most imported goods originate from developed countries. In the first six months of 1998 75.26 million US\$ was imported from Slovenia, or approximately 16% of the total registered imports. Hungary captures a share of 15.1% of total imports, Germany 13%, Austria 8.2%, Italy 7.3% .

Table 5.3. Imports by origin (x 1,000 US\$)

Country	January 1 - June 30, 1998		January 1 - June 30, 1999		% increase
	Value	Percent share in total imports	Value	Percent share in total imports	
Slovenia	26,172	11.32	75,262	16.05	288
Hungary	21,193	9.17	70,646	15.06	333
Germany	31,187	13.49	60,715	12.95	195
Austria	20,242	8.76	38,262	8.16	189
Italy	17,508	7.58	34,412	7.34	197
Croatia	2,838	1.23	19,047	4.06	671
Yugoslavia	-	-	15,922	3.40	-
USA	6,128	2.65	14,050	3.00	229
Bulgaria	9,558	4.14	11,568	2.47	121
Sweden	3,449	1.49	11,477	2.45	333
Switzerland	9,358	4.05	10,000	2.13	107
FYR Macedonia	3,280	1.42	7,910	1.69	241
Netherlands	3,000	1.30	7,785	1.66	260
Cyprus	3,957	1.71	6,752	1.44	171
Belgium	3,136	1.36	5,125	1.09	163
France	1,919	0.83	3,124	0.67	163
Other	68,200	29.51	76,893	16.40	113
Total	231,125	100.00	468,950	100.00	203

Source: RS Banking Agency, Banja Luka

The structure of imports according to the ownership type of the importers is shown in **Table 5.4.** Private importers realized 350.76 US\$ of imports in the first 6 months of 1999, or 74.8% of the total imports in the RS. Compared with the same period last year this represents an increase of more than 130% (in level). The State-owned importers accounted for 21.3% of the total imports in the observed period. We can conclude that the significance of the State sector as an importer is slowly diminishing.

Table 5.4. Ownership structure of the importers
January 1 - June 30, 1999

<i>Ownership type</i>	<i>Imports (x 1,000 US\$)</i>	<i>%</i>
State-owned	99,868	21.30
Private	350,760	74.80
Mixed	6,507	1.39
Foreign capital	4,214	0.90
Other	7,601	1.61
Total	468,950	100.00

Finally, **Table 5.5.** shows the trade deficits with the main trading partners. The figures confirm that the RS has been replacing (in 1999) imports originating from FR Yugoslavia with imports from other European countries. They also confirm that the RS could not achieve a corresponding export increase. As mentioned earlier, this is due to the lack of competitiveness of the domestic producers.

Table 5.5. Deficit with main trading partners
January 1 - June 30 (1998 and 1999)

	<i>1998</i> <i>(x 1,000 US\$)</i>	<i>1999</i> <i>(x 1,000 US\$)</i>	<i>% increase</i>
Germany	25,339	49,315	94.6
Italy	3,980	8,867	123.0
Austria	18,726	30,811	64.5
Slovenia	21,635	59,732	176.1

